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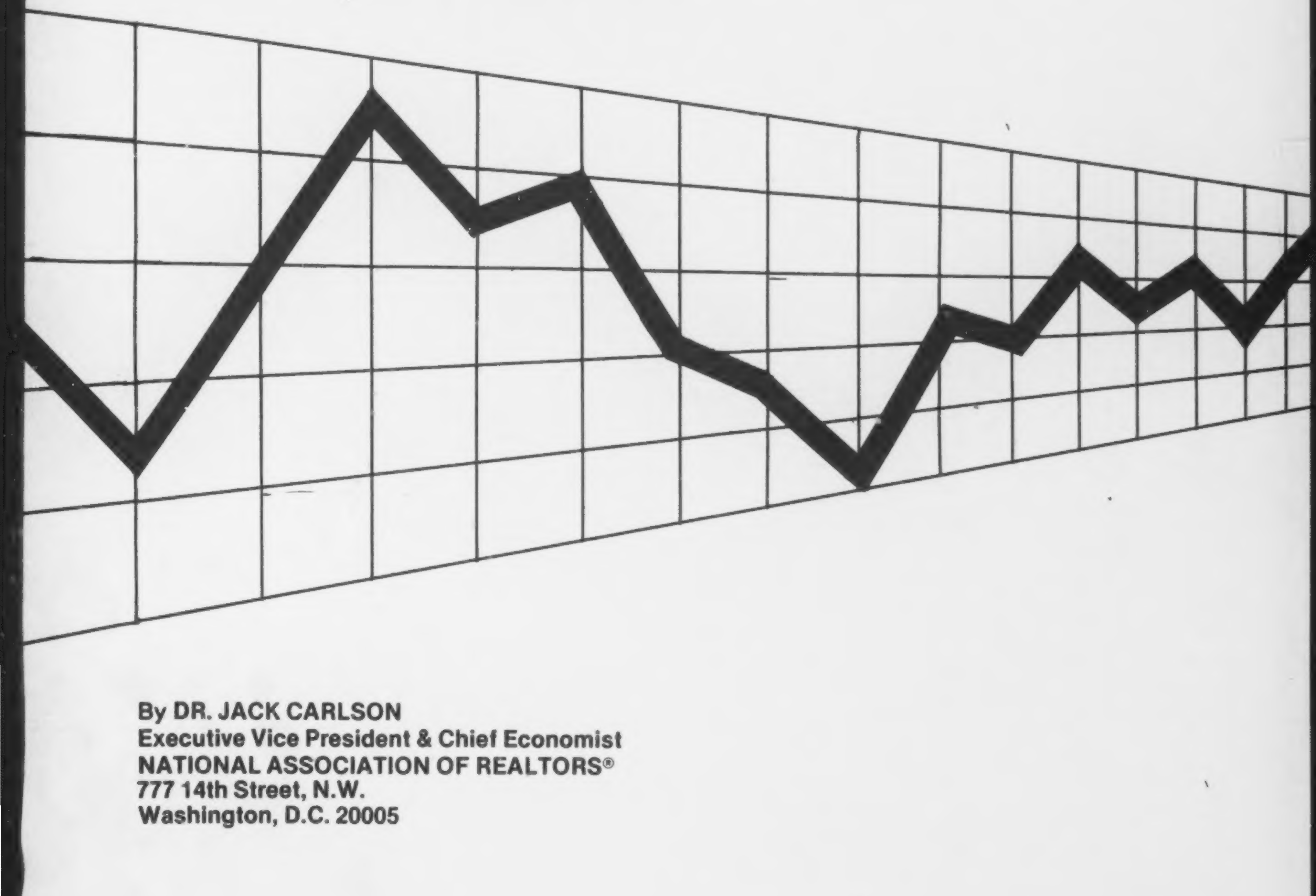
OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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NOVEMBER 1984

OUTLOOK FOR THE ECONOMY AND REAL ESTATE

Aggregate Economy

The economy has experienced a sharp slowdown during the third quarter due to the March to August increase in interest rates. Real or inflation-adjusted Gross National Product (GNP) increased 2.7 percent during the third quarter compared to 7.1 percent in the second quarter and 10.1 percent in the first quarter. The increase in third quarter GNP was due almost entirely to inventory investment as final sales remained virtually unchanged from the second quarter.

Despite this slowdown, it is unlikely that the economy is on the brink of a severe recession. The two primary conditions for a severe bust, a surge of inflation and inventories far in excess of needs to meet current sales, are not present at this time. The rates of increase of both prices and wages have been constant for about a year while inventories at all stages of production and distribution remain low.

Moreover, there are numerous indications that the economy is reaccelerating in response to the decline in interest rates over September and October:

- The Index of Leading Economic Indicators rose 0.4 percent in September following three consecutive monthly declines.
- Retail sales were up 1.6 percent in September after falling in July and August.
- Housing starts increased 9 percent in September with increases occurring in every region of the country.
- Domestic auto producers expect to operate near capacity for at least the remainder of the fourth quarter to meet increased sales and build inventories.

This reacceleration should result in real GNP growth of about 2 1/2 percent for the fourth quarter of 1984 and the first quarter of 1985. Then the economy should enter a two to three quarter transition period of sluggish and erratic growth with declining housing starts and slower growth of both consumption spending and business investment spending. By 1986 the recovery should resume but at a more moderate and sustainable pace.

Employment and Inflation

The civilian unemployment rate held at 7.4 percent in October, virtually the same level as September, August, and July, despite a large increase in total employment over the month. As measured by non-agricultural payrolls, total employment rose by 440,000 in October compared to increases of 231,000 in September and 173,000 in August. The unemployment rate may drop another one or two tenths of a percent in the next few months but should begin rising again in 1985 as the economy enters a growth recession where the growth of the economy is too slow to absorb all new entrants into the labor force.

The Consumer Price Index (CPI) increased at a compound annual rate of 3.6 percent during the third quarter, down slightly from the 3.7 percent annual rate of the second quarter. Inflation should remain low through 1985 due to moderate wage increases, stable energy prices, declining food prices, and a strong dollar which keeps import prices low and thereby restrains price increases domestically produced goods and services. For all of 1985 the CPI should increase just for 4 percent, down slightly from the 1984 level. However, as the recovery resumes in 1986 the rate of inflation should accelerate to the five percent level.

Monetary Policy and Interest Rates

Both short- and long-term interest rates continued to decline in October due to relatively weak private credit demand and a more accomodative stance by the Federal Reserve Board (FED). In response to the sharp slowdown of the economy, the FED has been aggressively supplying reserves to the banking system since early September. In response, the federal funds rate has fallen from an average of 11.7 percent during the first week of September to an average of 9.5 percent during the last week of October. Over the same period yields on 3-month Treasury bills have declined from 10.6 percent to 9.3 percent while most major banks reduced their prime lending rate from 13 percent to 12 percent. Long-term rates have also declined with the yield on 30-year Treasury bonds falling 100 basis points to 11.7 percent.

Interest rates are likely to rise slightly later this quarter and into the first quarter of 1985 in response to a temporary increase in total credit demand:

- Business loans outstanding should continue the increase begun in September following an actual decline in August.
- A large volume of offerings of corporate bonds are expected over this period.
- Consumer loan demand should be strong as domestic auto sales return to the 8 million unit annual rate.
- Treasury borrowing requirements should average about $60 billion during the last quarter of this year and the first quarter of 1985 compared to about $20 billion during the second quarter of 1984 and $40 billion during the third quarter.

After this temporary increase is passed, the reduced credit demands associated with the much slower economic growth of 1985 should allow interest rates to trend downward over the remainder of that year. By the final quarter of 1985 the yield on three month Treasury bills should be about 8.8 percent while the interest rate on 30-year, fixed-rate mortgage loans should be down to about 13 percent.

Real Estate Markets

Existing home sales fell 1.1 percent in September to a seasonally adjusted annual rate of 2.67 million units in response to high mortgage interest rates. This marks the fifth consecutive monthly decline from the previous peak of 3.07 million units of April. Housing starts rose 9 percent in September to a seasonally adjusted annual rate of 1.68 million units.

As is typical of this time of year, the median price of existing single-family homes sold in September declined $1,100 from the August level to $72,600. This price decline along with a rise in the median family income boosted the National Association of Realtors' Affordability Index 0.7 percentage points to 84.4. This means that a family earning the median income had 84.4 percent of the income needed to qualify to purchase the median-priced existing home.

Both resales and starts should decline modestly from current levels over 1985 due to slow growth of employment and income and continued high interest rates. Resales should total about 2.6 million units for all of 1985 and then rise to about 2.9 million units in 1986. Housing starts should total about 1.6 million units in 1985 and then rise to about 1.8 million units in 1986.

The rate of growth of construction of new commercial space should continue to trend downward through 1985 due to much reduced levels of investment in new office space. For all of 1985,new commercial building construction should increase just 7 percent compared to an expected increase of 33 percent from 1984. In contrast, the rate of growth of construction of new industrial buildings should increase to about 15 percent in 1985 from an expected increase of about 12 percent for 1984.

Table 1

NOVEMBER 1984

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:3	84:4	85:1	85:2	85:3	85:4	86:1	86:2	1982	1983	1984	1985	1986
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,701	3,760	3,825	3,861	3,892	3,953	4,026	4,109	3,069	3,305	3,665	3,883	4,157
Percent Change	6.3	6.5	7.1	3.7	3.3	6.4	7.6	8.5	3.8	7.7	10.9	5.9	7.1
Percent Change (without inflation)	2.7	2.5	2.5	0.0	-0.4	1.8	2.8	3.5	-2.1	3.7	6.8	1.9	2.4
Consumption	0.2	5.3	3.4	1.8	1.1	1.5	2.2	2.8	1.4	4.8	5.3	2.9	2.2
Durables	-3.6	11.4	4.1	-0.6	-2.4	0.0	2.4	3.8	-0.3	12.1	12.9	2.9	1.8
Nondurables	-0.5	4.9	2.9	2.0	1.5	1.4	1.7	2.0	0.6	3.7	5.0	2.9	1.8
Services	2.1	3.5	3.4	2.5	2.0	2.2	2.6	3.0	2.5	3.4	3.0	2.9	2.6
Residential Investment	2.7	-9.1	-3.8	-5.0	1.9	4.1	6.8	8.9	-15.0	41.7	12.9	-2.8	5.5
Nonresidential Investment	7.9	4.7	5.4	5.1	3.0	1.8	2.5	2.3	-4.7	2.5	18.7	5.9	2.8
Structures	1.8	1.6	4.0	4.2	1.8	0.8	2.8	3.0	0.2	-7.8	14.5	3.8	2.9
Equipment	10.5	5.8	6.0	5.4	3.5	2.2	2.4	2.1	-6.8	7.3	20.5	6.7	2.8
Exports	16.1	6.4	4.9	5.0	4.6	4.2	4.9	6.1	-7.8	-5.6	6.2	6.1	5.3
Imports	49.8	5.6	5.4	5.2	2.5	2.1	2.2	2.5	1.3	7.6	29.5	9.5	2.6
Government Purchases	8.6	3.3	3.0	3.4	2.6	1.0	1.7	1.5	2.0	-0.3	3.7	4.5	1.7
Consumption (% of GNP)	64.5	65.0	65.1	65.4	65.6	65.6	65.5	65.4	65.1	65.8	64.8	65.4	65.3
Residential Investment (% of GNP)	3.7	3.6	3.5	3.5	3.5	3.5	3.6	3.6	2.6	3.5	3.7	3.5	3.6
Nonresidential Investment (% of GNP)	12.5	12.6	12.7	12.8	13.0	13.0	12.9	12.9	11.3	11.1	12.4	12.9	12.9
Structures (% of GNP)	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.6	3.2	3.4	3.5	3.5
Equipment (% of GNP)	9.1	9.1	9.2	9.3	9.4	9.4	9.4	9.4	7.7	7.9	8.9	9.4	9.4
Inventory Change ($ billions)	72.4	57.6	51.5	30.4	8.5	9.8	12.8	17.7	-26.1	-13.5	63.6	25.1	19.8
Mfg. Capacity Utilization Rate (%)	83	82	82	82	81	80	80	80	71	75	82	81	81
Auto Sales (millions of units)	10.3	11.0	10.9	10.7	10.5	10.4	10.3	10.3	8.0	9.2	10.6	10.6	10.4
Domestic (% of total)	77.3	73.4	77.1	76.6	73.4	72.4	72.5	72.4	72.3	74.0	76.5	74.9	71.9
Imported (% of total)	22.7	26.6	22.9	23.4	26.6	27.6	27.5	27.6	27.9	26.0	23.5	25.1	28.1
Manufacturing Industrial Production (% change)	7.2	1.7	2.4	0.7	-1.9	0.5	2.5	4.1	-8.5	7.8	11.4	2.2	2.3
Common Market	8.9	3.6	4.6	2.8	3.5	2.1	1.1	3.1	-1.4	0.7	2.9	3.3	2.2
Japan	5.3	8.9	8.7	3.0	2.6	1.3	1.4	2.4	0.4	3.5	10.5	6.0	2.1
Employment(millions)(civilian:household basis)	105.2	106.1	106.6	106.9	107.0	107.3	107.7	108.1	99.5	100.8	105.0	107.0	108.5
Unemployment Rate (%) (civilian)	7.5	7.3	7.3	7.5	7.8	7.9	8.0	8.1	9.7	9.6	7.5	7.6	8.0
Personal Income per Household (average)<1>	38,965	39,550	40,199	40,532	40,854	41,438	42,146	42,899	33,690	35,447	38,578	40,756	43,265
Percent Change -- Year Ago (w/o inflation)	5.9	4.6	3.4	1.9	1.0	0.8	0.6	1.3	-0.5	1.4	5.3	1.8	1.5
Personal Taxes per Household (average)	7,059	7,181	7,296	7,364	7,428	7,558	7,683	7,851	6,441	6,484	6,971	7,412	7,934
Percent Change -- Year Ago (w/o inflation)	6.4	5.6	4.2	2.6	1.2	1.1	1.1	2.1	-2.2	-3.1	3.6	2.3	2.4
Percent of Personal Income	18.9	18.9	19.0	19.0	19.0	19.1	19.1	19.1	19.9	19.1	18.9	19.0	19.2
Disposable Income per Household (average)	31,907	32,369	32,904	33,168	33,426	33,880	34,463	35,048	27,249	28,964	31,607	33,344	35,331
Percent Change--Year Ago (w/o inflation)	5.7	4.4	3.3	1.8	1.0	0.8	0.6	1.2	-0.1	2.5	5.7	1.7	1.4
Household Interest Payments (% of total)	10.5	10.3	10.3	10.4	10.7	10.6	10.4	10.3	9.6	9.8	10.4	10.5	10.2
Net Worth per Household (average)	77,375	79,136	80,680	82,194	83,684	85,329	87,253	89,327	66,177	73,908	77,075	82,972	90,467
Percent Change -- Year Ago (w/o inflation)	-0.6	1.3	2.6	3.9	4.0	3.6	3.9	4.1	-1.8	7.6	0.5	3.5	4.3
Consumer Price Inflation (CPI)	3.6	4.2	4.1	4.0	3.9	4.3	5.0	5.1	6.2	3.2	4.3	4.0	4.7
Gross National Product Inflation (GNP Deflator)	3.6	3.9	4.5	3.7	3.7	4.5	4.7	4.9	6.0	3.8	3.8	4.0	4.6
Personal Consumption Inflation	4.5	3.7	3.7	3.8	3.8	4.1	4.8	4.9	5.9	3.7	3.3	3.7	4.5
Residential Construction Inflation	-0.3	0.8	4.0	4.3	4.3	4.9	6.0	6.4	3.0	1.7	3.3	3.4	5.7
Nonresidential Construction Inflation	2.3	3.4	5.3	5.5	5.7	6.3	6.9	7.1	4.9	-1.0	0.5	4.5	6.7
Producers Price Inflation (WPI)	-0.7	1.5	1.8	2.4	2.7	4.5	5.0	5.0	2.0	1.3	2.5	1.9	4.5
Compensation per Manhour (% change)	3.4	5.1	6.7	5.4	5.4	6.1	7.0	6.3	8.0	4.8	4.2	5.3	6.3
Productivity (% change)	2.3	2.2	1.4	1.4	1.1	1.3	1.1	1.6	0.2	3.4	3.0	1.8	1.3
Unit Labor Cost (% change)	0.8	2.9	5.2	3.9	4.2	4.7	5.8	4.7	7.8	1.3	1.2	3.4	4.9
Unit Capital Cost (% change)	4.5	4.4	4.2	4.0	3.8	3.5	3.3	3.1	9.5	6.9	4.6	3.9	3.1
Before Tax Corporate Profits ($ billions)<2>	240	242	237	230	220	219	222	228	181	213	247	226	233
Corporate Tax Liability	95	98	96	91	84	83	86	89	76	86	99	88	92
After Tax Profits	145	144	141	139	136	136	136	139	105	127	147	138	141
Inventory Valuation Adjustment	-1	-4	-9	-12	-15	-20	-24	-25	-9	-11	-6	-14	-26
Capital Consumption Adjustment	59	63	72	76	80	84	85	86	3	33	55	78	86
Profits from Current Production (with IVA, CCA)	203	203	204	203	201	200	197	200	98	149	196	202	202
Adjusted for Inflation (84:1 base)	200	197	197	194	190	187	182	183	105	153	194	192	183
Percent Change - Year Ago	22.2	11.1	6.5	0.2	-5.1	-5.2	-7.6	-5.8	-14.6	46.0	26.8	-1.0	-4.5
Per Unit of Output (% of GNP)	5.5	5.4	5.3	5.3	5.2	5.1	4.9	4.9	3.2	4.5	5.4	5.2	4.9
Effective Corporate Tax Rate (%)<2>	30	31	31	30	28	28	29	30	39	34	32	29	30
Federal Tax Receipts (Unified basis)	710	647	653	831	733	674	666	919	609	613	681	723	773
Percent of GNP	19.2	17.2	17.1	21.5	18.8	17.1	16.5	22.4	19.8	18.6	18.6	18.6	18.6
Federal Expenditures (Unified basis)	844	892	930	943	932	966	993	1,005	740	803	855	943	1,014
Percent of GNP	22.8	23.7	24.3	24.4	23.9	24.4	24.7	24.5	24.1	24.3	23.3	24.3	24.4
Surplus or Deficit (Unified basis)	-134	-245	-276	-112	-199	-292	-327	-86	-131	-190	-174	-220	-241
% of GNP	3.6	6.5	7.2	2.9	5.1	7.4	8.1	2.1	4.2	5.8	4.7	5.7	5.8
% of Personal Savings	81.4	159.9	173.2	73.1	132.6	185.1	194.4	49.4	97.8	158.1	112.9	141.0	139.3
% of Net Domestic Savings	40.1	75.5	83.5	35.0	64.1	92.9	101.8	25.9	67.3	80.0	54.1	68.9	72.5

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, and Dick Peach.

Table 2 NOVEMBER 1984

REAL ESTATE AND FIANNCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:3	84:4	85:1	85:2	85:3	85:4	86:1	86:2	1982	1983	1984	1985	1986
REAL ESTATE MARKETS													
Existing Single-Family Home Sales (thousands)	2,713	2,713	2,699	2,620	2,557	2,522	2,655	2,847	1,948	2,719	2,851	2,600	2,901
Percent Change - Year Ago	-2.1	-1.6	-8.2	-13.7	-5.7	-7.0	-1.6	8.7	-17.2	39.6	4.8	-8.8	11.6
Dollar Volume (billions)	237.0	233.0	234.6	231.2	226.5	221.2	237.4	260.2	156.5	224.5	245.7	228.4	264.5
Existing Home Prices - Median ($1000's)	73.6	73.0	74.4	76.0	76.6	76.1	77.9	79.7	67.7	69.8	72.9	75.8	79.6
Percent Change - Year Ago	3.6	4.2	3.7	3.9	4.1	4.3	4.6	4.9	2.3	3.2	4.4	4.0	5.0
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	704	664	673	672	664	645	655	671	754	633	671	663	669
Percent of Household Income	23	21	21	21	20	20	20	20	28	22	22	20	19
NAR Affordability Index	83.9	87.5	86.1	84.5	83.9	86.8	87.0	87.5	68.4	82.0	86.1	85.3	88.2
New Single-Family Home Sales (thousands)	616	641	600	570	590	610	635	670	417	626	645	592	672
Percent Change - Year Ago	4.9	-4.6	-13.3	-9.9	-4.2	-4.9	5.9	17.6	-4.3	50.1	3.1	-8.2	13.5
New Home Prices - Median ($1000's)	81.4	81.7	82.5	83.4	84.3	85.5	86.8	88.3	69.3	75.5	80.4	83.9	89.1
Percent Change - Year Ago	4.8	7.7	5.9	3.7	3.6	4.6	5.3	6.0	0.7	8.9	6.5	4.4	6.2
New Home Prices--Mean ($1000's, Quality Adjusted)	94.9	93.3	94.5	95.5	98.0	97.4	99.1	100.7	87.8	89.7	93.2	96.4	101.8
Percent Change - Year Ago	4.6	3.4	3.8	2.2	3.3	4.4	4.9	5.4	2.8	2.1	3.9	3.4	5.7
New Mortgage Commitments ($ billions)	166.3	155.4	152.4	150.7	151.2	153.1	158.4	173.3	64.8	163.4	179.9	151.8	177.9
Percent Change - Year Ago	-13.4	-5.3	-20.3	-27.0	-9.1	-1.4	4.0	15.0	8.1	152.1	10.1	-15.6	17.2
Mortgage Debt Outstanding ($ billions)	1,998	2,074	2,150	2,225	2,300	2,376	2,293	2,241	1,629	1,752	1,967	2,263	2,237
Homeowners' Equity ($ billions)	2,731	2,787	2,830	2,854	2,878	2,913	2,956	3,007	2,336	2,519	2,714	2,869	3,039
Housing Inventory (millions)	91.3	91.7	92.0	92.4	92.7	93.0	93.4	93.7	88.5	89.6	91.1	92.5	93.9
Private Housing Starts (thousands)	1,656	1,652	1,636	1,635	1,618	1,670	1,747	1,807	1,056	1,704	1,793	1,640	1,798
Single-Family	977	1,025	1,007	1,011	1,015	1,081	1,102	1,146	663	1,066	1,104	1,028	1,145
Percent of Total	59.0	62.1	61.6	61.8	62.7	64.7	63.1	63.4	62.8	62.6	61.5	62.7	63.7
Multi-Family	679	627	628	624	603	589	645	661	394	637	688	611	653
Percent of Total	41.0	37.9	38.4	38.2	37.3	35.3	36.9	36.6	37.2	37.4	38.5	37.3	36.3
Mobile Home Shipments (thousands)	304	307	311	309	308	297	302	302	240	296	301	306	300
Rental Vacancy Rate (%)	5.5	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.3	5.6	5.5	5.4	5.4
Unsold New Homes (% of sales)	58.2	60.2	59.8	57.1	54.5	53.2	52.7	53.2	65.2	43.0	52.7	56.1	54.1
Office Vacancy Rate (%)<1>	11.5	11.1	10.7	10.4	10.1	9.9	9.7	9.5	8.0	11.7	12.3	10.3	9.5
Industrial Vacancy Rate (%)<1>	4.4	4.2	4.0	3.9	3.8	3.8	3.7	3.7	4.4	4.9	4.5	3.9	3.6
New Commercial Building Construction (% Ch Value)	2.8	3.4	3.6	4.5	2.4	8.7	14.1	13.3	9.0	-4.2	32.8	6.8	10.7
New Industrial Building Construction (% Ch Value)	-2.8	37.5	15.1	15.1	9.5	8.2	8.4	9.6	2.5	-25.7	11.5	15.4	10.3
FIANNCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-8%)	4.6	3.0	4.3	5.0	6.2	7.5	6.0	5.9	6.6	11.0	6.6	4.8	6.3
M1 Velocity (% change)	1.7	3.5	2.7	-1.2	-2.7	-1.0	1.5	2.4	-2.6	-3.1	4.0	1.1	0.7
M2 (% change)(FED Target 6-9%)	6.2	6.4	6.6	6.5	8.1	8.9	7.6	7.2	9.5	12.6	7.5	6.9	7.6
M2 Velocity (% change)	0.1	0.1	0.5	-2.6	-4.5	-2.3	0.1	1.2	-5.3	-4.4	3.2	-0.9	-0.6
Monetary Base (% change)	7.9	4.5	5.8	5.0	4.5	4.8	5.7	6.2	6.9	9.5	8.3	5.6	5.6
Flow of Funds													
Supply (total)	456	442	443	432	423	431	438	451	212	280	426	432	454
Personal Savings	165	153	160	153	150	158	168	174	136	118	154	155	173
Savings Rate	6.3	5.8	5.9	5.6	5.4	5.6	5.9	6.0	6.2	5.0	6.0	5.6	5.9
Net Business Savings	122	119	118	115	110	107	102	103	29	76	116	112	104
State + Local Govt. Savings	47	52	53	52	50	50	51	54	33	44	52	51	55
Foreign Funds(current account deficit)	122	117	112	113	114	116	117	120	13	42	104	114	121
Demand (total)	399	404	423	238	325	418	468	244	165	325	411	351	405
Consumer Installment Debt(net change)	76	45	33	18	17	17	19	23	19	40	72	21	26
Commercial+Industrial Loans(net change)	50	21	19	16	15	13	21	29	22	-2	45	16	32
Home Mortgage Debt(net change)	139	94	94	92	95	96	102	106	-6	96	121	94	106
Federal Deficit	134	245	276	112	199	292	327	86	131	190	174	220	241
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	14.7	14.0	13.9	13.6	13.3	13.0	12.9	12.9	17.2	13.9	14.2	13.4	12.9
Real Mortgage Rate	11.2	10.1	9.4	9.9	9.6	8.5	8.2	8.0	12.9	10.2	10.3	9.4	7.9
1 Year ARM (without buy-down)	13.5	12.5	12.3	11.9	11.6	11.5	11.4	11.5	14.0	11.3	12.8	11.8	11.5
Real Mortgage Rate	9.9	8.5	7.7	8.2	8.0	7.1	6.7	6.6	9.7	7.5	9.0	7.7	6.5
Corporate Bond Rate (AAA)	13.0	12.3	12.4	12.0	11.7	11.4	11.3	11.2	13.8	12.0	12.7	11.9	11.3
Government Bond Rate	12.8	12.0	11.9	11.6	11.1	10.8	10.6	10.5	12.9	11.3	12.5	11.4	10.6
Real Government Bond Rate	9.3	8.0	7.4	7.9	7.5	6.3	6.0	5.6	8.7	7.6	8.7	7.3	5.6
Federal Funds Rate	11.4	10.1	10.4	10.0	9.7	9.7	9.6	9.8	12.3	9.1	10.4	10.0	9.9
3 Month Treasury Bill Rate	10.3	9.6	9.5	9.2	8.9	8.8	8.7	8.9	10.6	8.6	9.7	9.1	8.9
Real 3 Month T-Bill Rate	6.7	5.7	4.9	5.4	5.2	4.4	4.1	4.0	6.4	4.8	5.9	5.0	3.9
1 Year Treasury Bill Rate	11.8	10.8	10.6	10.2	9.9	9.8	9.7	9.8	12.3	9.6	11.1	10.1	9.8
Commercial Paper Rate	11.1	10.1	10.2	9.8	9.5	9.5	9.4	9.6	11.9	8.9	10.3	9.8	9.7
Rate on Money Market Fund Shares	11.3	10.3	10.4	10.0	9.6	9.6	9.6	9.8	12.1	9.0	10.5	9.9	9.9
Prime Rate	13.0	12.2	11.9	11.9	11.9	11.4	11.4	11.4	14.9	10.8	12.1	11.8	11.6

<1> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, and Dick Peach.

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

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DECEMBER 1984

Outlook For The Economy and Real Estate

Aggregate Economy

The strong growth in real output during the first half of this year has been replaced by slower less eratic growth as demand conditions weakened due to the existence of high real interest rates earlier this year. Third quarter growth in real GNP has been revised downward from 2.7 percent to 1.9 percent. The smaller than expected increase in third quarter growth, despite a rise of 5.9 percent in domestic demand, can be attributed to a slowdown in personal consumption expenditures and a large increase in imports. Underscoring this slowing trend has been a decline in factory orders and durables in October. Howevever, retail sales as well as construction expenditures are expected to increase in November, an indication that lower interest rates will help to stimulate the economy and sustain economic growth in the fourth quarter. Fourth quarter growth in real GNP is projected to be 2.0 percent leaving overall growth for all of 1984 at 6.7 percent.

Real GNP growth should remain around 2.0 percent for the first quarter of 1985 before declining to 1.1 percent by the second quarter. This small downturn in the middle of 1985 represents a transistion period before the next acceleration begins by the fourth quarter of 1985 when real GNP growth should climb to 2.6 percent. Unlike past downturns, this one will be very small and short. Prospects of a recession are unlikely as the economy is not expected to experience labor shortages, spiraling interest rates or falling plant capacity; occurences that ususally precede a slump. Instead, leaner inventories and lower real interest rates will be major factors in buffering the economy from any serious declines in output. During past downturns, existence of large inventories during a period of declining output has increased costs therefore absorbing funds that could have been used for much needed investment. The trend toward leaner inventories will avoid this problem. In addition, lower real interest rates resulting from expansionary fiscal and monetary policies will stimulate demand in interest sensitive industries thus partially offsetting declines in output.

Foreign producers continue to absorb the rising share of U.S. spending while domestic producers continue to suffer losses. Imports, increasing to 26.1 percent of capital spending in the third quarter of 1984 compared to 15.7 percent in 1980, will continue to erode U.S. output. Continued import penetration is expected to hold down real growth in output til mid - 1985 by squeezing profits, reducing employment, and depressing capital goods spending in manufacturing industries; consequently, pushing down interest rates even further. However, the continued downward trend in interest rates will trigger a resurgence in demand for residential construction, automobiles and household durables. The rebound in these industries would eventually boost capital spending only after a one or two period lag allowing for profits and confidence to improve.

Employment and Inflation

The overall unemployment rate declined 0.3 percent in November to 7.0 percent, the sharpest drop since June. In addition, total employment rose by nearly 300,000 jobs with most of the growth in the service sectors. The improvement in the employment figures represents the stimulative effect recent declines in interest rates has had on the economy and reinforces confidence that the present slowdown will be temporary and not result in a recession. Unemployment for all of 1984 is expected to be 7.6 percent, two percentage points below the 1983 annual rate. The jobless rate is expected to increase slightly into 1985 as real output growth continues to slow slightly and reach 8 percent by the end of next year.

The consumer price index increased on a seasonally adjusted basis by 0.4 percent in October, this is equivalent to a compound annual rate of 4.9 percent and is the same as the September rise. Declines in food and fuel prices continue to be the major factors restraining inflation, while prices of non-energy services (which comprise 35 percent of the index) have been increasing at a faster pace since the beginning of 1983. The consumer price index for all of 1984 is expected to increase 4.3 percent. Inflation is expected to increase at a modest 4.0 percent annual rate through 1985 as oil prices are expected to decline further in response to the weak global recovery. The continued strength of the dollar will keep down import prices as well as the prices of their competitors in the domestic market. Although, the value of the dollar will decline slightly into 1985 as represented by a decline in the trade-weighted exchange rate, it will still remain well above its 1983 levels thus it is still "strong" relative to other currencies. The trade- weighted exchange rate is a new addition to the forecast table and represents a weighted index with a base year of 1967 of the U.S. dollar against foreign currency.

Monetary Policy

The federal reserve in response to an unexpectedly strong downturn in economic growth for the third quarter and modest levels in the rate of inflation began a more accomodative monetary policy in early September in an attempt to stabilize the economy. They aggressively supplied reserves to the banking system thus increasing the supply of loanable funds and pushing the Federal Funds rate to 9 percent. The slower growth in private credit demands in addition to the increase in loanable funds has removed the upward pressure on interest rates allowing them to decline substantially. Since peaking in August, short term rates have declined 165 basis points to 8.7 percent in November. Reflecting lower inflationary expectations, long term rates have declined almost 200 basis points to 11.5 percent in November from their June peaks. In addition, the term structure of interest rates has also flattened significantly -- the spread between long term and short term rates is 60-130 basis points lower then the June rates. This is another indication that confidence about future price trends is improving. Further signs of a loosening grip by the Federal Reserve include a reduction in the discount rate to 8-1/2 percent compared to 9 percent in early September. Major banks have responded by cutting their prime lending rates to 11-1/2 percent in November. This has been the fifth reduction in the prime since late September.

Over the forecast interval, further easing measures by the Federal Reserve are expected including a reduction in its discount rate to 8 percent by the end of this year. Both short and long term rates are expected to slowly decline through 1985 til the middle of 1986. Once private credit demands rebound in response to these lower interest rates and the deficit continues to absorb the supply of loanable funds interest rates will begin to trend upward by the middle of 1986.

Real Estate Markets

The housing industry is experiencing modest gains as lower interest rates has improved affordability for homebuyers. It is estimated that for every one percent decline in real interest rates (after adjusting for inflation), 400,000 to 500,000 more families are able to satisfy their housing needs. Underscoring the strong pent up demand for housing that has existed due to high real interest rates during the first half of this year was a leveling off of resales in October after five months of decline. Resales for all of 1984 are expected to total 2.8 million units. As interest rates continue to decline, resales are expected to trend upward through 1985 reaching the 2.7 million units for all of 1985. Housing starts, which declined 9.8 percent in October, have been quite volatile and are also expected to begin to trend upward through 1985 in response to an improvement in affordability.

Conventional and adjustable rate mortgages continue to decline. Fixed rate mortgages declined 54 basis points to 14.16 percent in November over October's rate while adjustable rates have been declining more slowly by 35 basis points to 12.49 percent. As bond yields continue to trend downward, mortgage rates are expected to follow suit although at a slower pace. Fixed rate mortgages should decline to 13 percent by the end of 1985. Adjustable rate mortgages are expected to fall to 10.8 percent. Lower interest rates will translate into a lower payment to income ratio and will therefore make homeownership relatively less costly in 1985.

Prices of resales are expected to increase at a pace equal to or slightly above overall inflation through next year, while new home prices are likely to accelerate slightly faster. The median existing single-family home price should be about $73,600 for the fourth quarter of this year; 3.6 percent above the median a year earlier. The median is likely to increase 4.3 percent by the end of 1985 to $76,800, a rate slightly faster than the rate of inflation. This year new single family home prices for the fourth quarter will increase 3.3 percent from a year earlier to $80,200. Rising faster than inflation, the median new-home price is expected to increase an additional 4.7 percent to $84,500 by the end of 1985.

The current decline in construction of new commercial space is expected to continue through the first quarter of next year in response to the slower pace in the residential market during the third quarter. Commercial construction activity should gradually increase by the second quarter of next year as lower interest rates makes investment in these areas more attractive. Despite the current slowdown, commercial construction activity for 1984 is likely to be nearly 34 percent higher than in 1983. This construction activity should increase about 5.6 percent in 1985 and an additional 13.3 percent in 1986.

In contrast, new industrial building construction activity, which is now running about 23 percent ahead of last year's fourth quarter, should gradually slow next year. By the fourth quarter of 1985, the growth rate of industrial building construction is likely to be about 6 percent.

Table 1

DECEMBER 1984

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:3	84:4	85:1	85:2	85:3	85:4	86:1	86:2	1982	1983	1984	1985	1986
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,695	3,749	3,807	3,852	3,892	3,962	4,038	4,132	3,069	3,305	3,660	3,878	4,179
Percent Change	5.7	5.9	6.3	4.9	4.2	7.4	7.9	9.7	3.8	7.7	10.8	5.9	7.8
Percent Change (without inflation)	1.9	2.0	2.0	1.1	0.4	2.6	2.9	4.6	-2.1	3.7	6.7	2.0	3.0
Consumption	0.6	4.1	3.9	2.8	2.2	1.8	2.3	3.1	1.4	4.8	5.3	3.2	2.6
Durables	-2.2	8.8	5.4	2.6	1.8	0.0	2.2	4.3	-0.3	12.1	12.9	4.1	2.8
Nondurables	-1.3	2.4	3.5	2.8	2.3	2.1	2.0	2.6	0.6	3.7	4.7	2.7	2.4
Services	3.1	3.9	3.6	2.8	2.3	2.3	2.5	3.0	2.5	3.4	3.2	3.2	2.7
Residential Investment	-4.5	-5.6	-0.9	3.2	6.1	4.7	6.5	6.5	-15.0	41.7	12.7	-0.2	6.4
Nonresidential Investment	15.8	4.4	1.3	0.7	0.8	2.2	3.7	6.0	-4.7	2.5	19.8	4.6	3.9
Structures	7.0	2.2	1.0	0.9	1.8	3.4	7.5	8.8	0.2	-7.8	15.3	3.3	5.8
Equipment	19.6	5.3	1.4	0.6	0.4	1.8	2.3	5.0	-6.8	7.3	21.7	5.1	3.1
Exports	8.8	8.5	5.2	5.5	5.5	5.6	6.8	7.9	-7.8	-5.6	5.5	6.0	6.7
Imports	55.4	9.4	6.1	5.0	3.8	3.9	4.0	4.6	1.3	7.6	30.5	11.2	4.3
Government Purchases	6.4	6.3	2.9	3.2	2.3	0.6	1.0	1.7	2.0	-0.3	3.6	4.7	1.5
Consumption (% of GNP)	64.7	65.1	65.3	65.6	65.9	65.8	65.7	65.4	65.1	65.8	64.9	65.7	65.4
Residential Investment (% of GNP)	3.7	3.6	3.6	3.6	3.6	3.6	3.7	3.7	2.6	3.5	3.7	3.6	3.7
Nonresidential Investment (% of GNP)	12.8	12.9	12.8	12.8	12.8	12.8	12.8	12.9	11.3	11.1	12.5	12.8	12.9
Structures (% of GNP)	3.5	3.5	3.5	3.5	3.5	3.5	3.6	3.6	3.6	3.2	3.5	3.5	3.6
Equipment (% of GNP)	9.3	9.3	9.3	9.3	9.3	9.3	9.3	9.3	7.7	7.9	9.0	9.3	9.3
Inventory Change ($ billions)	68.5	52.9	43.9	30.0	10.8	18.8	22.5	33.1	-26.1	-13.5	61.4	25.9	31.4
Mfg. Capacity Utilization Rate (%)	83	82	82	81	80	80	80	81	71	75	82	81	81
Auto Sales (millions of units)	10.3	10.9	10.9	10.8	10.6	10.5	10.5	10.5	8.0	9.2	10.6	10.7	10.5
Domestic (% of total)	77.3	73.8	77.3	77.0	73.8	72.4	72.2	72.0	72.3	74.0	76.6	75.1	71.5
Imported (% of total)	22.7	26.2	22.7	23.0	26.2	27.6	27.8	28.0	27.9	26.0	23.4	24.9	28.5
Manufacturing Industrial Production (% change)	7.2	1.9	0.7	-0.5	-1.0	1.5	3.1	5.4	-8.5	7.8	11.5	1.8	3.1
Common Market	10.2	2.6	4.7	2.8	3.5	2.9	2.0	3.5	-1.4	0.7	2.9	3.4	2.7
Japan	6.7	8.9	8.8	3.2	2.9	1.5	1.5	2.5	0.4	3.5	10.7	6.3	2.3
Employment(millions)(civilian:household basis)	105.2	106.0	106.4	106.7	107.0	107.4	107.9	108.3	99.5	100.8	105.0	106.9	108.7
Unemployment Rate (%) (civilian)	7.5	7.4	7.5	7.6	7.8	8.0	8.0	8.0	9.7	9.6	7.6	7.7	7.9
Personal Income per Household (average)<1>	38,919	39,507	40,121	40,523	40,859	41,461	42,167	42,997	33,653	35,415	38,539	40,741	43,371
Percent Change -- Year Ago (w/o inflation)	5.9	4.6	3.3	2.0	1.1	1.0	0.8	1.5	-0.5	1.5	5.3	1.9	1.8
Personal Taxes per Household (average)	7,025	7,124	7,231	7,319	7,389	7,527	7,657	7,854	6,434	6,478	6,945	7,367	7,936
Percent Change -- Year Ago (w/o inflation)	6.0	4.8	3.5	2.2	1.3	1.5	1.6	2.6	-2.2	-3.0	3.3	2.1	2.9
Percent of Personal Income	18.8	18.8	18.8	18.9	18.9	19.0	19.0	19.1	19.9	19.1	18.8	18.9	19.1
Disposable Income per Household (average)	31,894	32,383	32,889	33,204	33,469	33,934	34,510	35,143	27,219	28,938	31,594	33,374	35,434
Percent Change--Year Ago (w/o inflation)	5.7	4.5	3.3	2.1	1.2	0.9	0.8	1.3	-0.1	2.5	5.7	1.9	1.6
Household Interest Payments (% of total)	10.5	10.4	10.2	10.3	10.6	10.6	10.4	10.4	9.6	9.8	10.4	10.4	10.3
Net Worth per Household (average)	77,282	78,778	79,790	80,821	82,178	83,700	85,536	87,756	66,105	73,841	76,928	81,622	88,826
Percent Change -- Year Ago (w/o inflation)	-0.6	0.9	1.7	2.4	2.4	2.1	2.8	3.9	-1.9	7.6	0.4	2.1	4.0
Consumer Price Inflation (CPI)	3.6	4.4	3.9	3.9	4.0	4.5	5.0	5.1	6.2	3.2	4.3	4.0	4.8
Gross National Product Inflation (GNP Deflator)	3.7	3.8	4.2	3.7	3.8	4.7	4.8	4.9	6.0	3.8	3.8	3.9	4.6
Personal Consumption Inflation	4.3	4.0	3.4	3.6	3.9	4.4	4.7	4.8	5.9	3.7	3.3	3.7	4.5
Residential Construction Inflation	4.5	0.9	2.8	4.3	4.5	5.1	5.9	6.5	3.0	1.7	3.9	3.8	5.7
Nonresidential Construction Inflation	2.0	2.5	4.4	4.9	5.5	6.1	6.7	7.0	4.9	-1.0	0.4	4.0	6.5
Producers Price Inflation (WPI)	-0.7	-0.1	1.5	2.1	3.3	4.8	5.4	5.4	2.0	1.3	2.4	1.5	4.9
Compensation per Manhour (% change)	3.6	4.0	7.8	6.5	6.2	7.0	7.9	7.2	8.0	4.8	4.2	5.8	7.2
Productivity (% change)	0.0	1.1	1.2	1.3	1.5	1.9	1.7	1.8	0.2	3.4	2.8	1.4	1.7
Unit Labor Cost (% change)	3.9	2.6	6.5	5.1	4.7	5.0	6.1	5.3	7.8	1.3	1.4	4.3	5.4
Unit Capital Cost (% change)	4.4	4.2	4.0	3.7	3.5	3.3	3.2	3.0	9.5	6.9	4.6	3.6	3.0
Before Tax Corporate Profits ($ billions)<2>	231	224	215	214	206	207	212	225	181	213	240	211	228
Corporate Tax Liability	92	89	85	83	78	79	85	92	76	86	96	81	94
After Tax Profits	139	134	130	131	128	128	128	133	105	127	144	129	135
Inventory Valuation Adjustment	0	0	-5	-10	-15	-22	-26	-27	-9	-11	-5	-13	-28
Capital Consumption Adjustment	58	63	72	76	79	83	84	85	3	33	55	78	85
Profits from Current Production (with IVA, CCA)	197	198	197	197	192	190	186	191	98	149	194	194	191
Adjusted for Inflation (84:1 base)	194	192	190	188	182	178	172	175	105	153	191	184	174
Percent Change - Year Ago	18.3	8.5	2.6	-2.8	-6.2	-7.6	-9.2	-7.3	-14.6	46.0	25.0	-3.6	-5.8
Per Unit of Output (% of GNP)	5.3	5.3	5.2	5.1	4.9	4.8	4.6	4.6	3.2	4.5	5.3	5.0	4.6
Effective Corporate Tax Rate (%)<2>	30	30	29	28	28	28	30	31	39	34	32	28	32
Federal Tax Receipts (Unified basis)	701	636	639	822	726	670	664	923	609	613	676	714	776
Percent of GNP	19.0	17.0	16.8	21.3	18.7	16.9	16.4	22.3	19.8	18.6	18.5	18.4	18.6
Federal Expenditures (Unified basis)	833	892	928	939	927	961	988	999	740	803	852	939	1,007
Percent of GNP	22.6	23.8	24.4	24.4	23.8	24.3	24.5	24.2	24.1	24.3	23.3	24.2	24.1
Surplus or Deficit (Unified basis)	-133	-256	-288	-117	-201	-291	-324	-76	-131	-190	-176	-224	-231
% of GNP	3.6	6.8	7.6	3.0	5.2	7.4	8.0	1.8	4.2	5.8	4.8	5.8	5.5
% of Personal Savings	80.7	159.3	176.1	74.8	137.9	192.2	201.4	44.9	97.8	158.1	112.6	145.3	139.3
% of Net Domestic Savings	40.7	79.5	89.2	37.3	68.1	98.0	106.5	23.8	67.3	80.0	55.2	73.1	73.3

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc,
Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, and Dick Peach.

Table 2

DECEMBER 1984

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:3	84:4	85:1	85:2	85:3	85:4	86:1	86:2	1982	1983	1984	1985	1986
REAL ESTATE MARKETS													
Existing Single-Family Home Sales (thousands)	2,700	2,636	2,643	2,663	2,729	2,780	2,797	2,930	1,948	2,719	2,828	2,703	3,000
Percent Change - Year Ago	-2.5	-4.4	-10.1	-12.3	1.1	5.4	5.8	10.0	-17.2	39.6	4.0	-4.4	11.0
Dollar Volume (billions)	235.9	228.4	231.5	236.8	243.6	245.8	252.3	270.2	156.5	224.5	244.3	239.4	276.2
Existing Home Prices - Median ($1000's)	73.6	73.7	75.0	76.6	77.2	76.8	78.5	80.5	67.7	69.8	73.0	76.4	80.3
Percent Change - Year Ago	3.6	5.2	4.5	4.7	5.0	4.3	4.7	5.1	2.3	3.2	4.6	4.6	5.1
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	702	665	657	662	650	651	666	697	754	633	670	655	699
Percent of Household Income	23	21	21	20	20	20	20	20	28	22	22	20	20
NAR Affordability Index	83.9	85.6	88.9	89.7	90.3	92.4	91.7	90.7	68.4	82.0	85.7	90.3	91.2
New Single-Family Home Sales (thousands)	616	626	627	608	569	558	637	662	417	626	642	591	670
Percent Change - Year Ago	4.9	-6.8	-9.3	-4.0	-7.6	-10.9	1.6	8.9	-4.3	50.1	2.5	-8.0	13.4
New Home Prices - Median ($1000's)	80.2	80.7	81.4	82.3	83.3	84.5	85.8	87.3	69.3	75.5	79.8	82.9	88.1
Percent Change - Year Ago	3.3	6.3	4.4	2.3	3.9	4.7	5.5	6.1	0.7	8.9	5.8	3.8	6.3
New Home Prices--Mean ($1000's, Quality Adjusted)	94.9	94.3	95.3	96.2	97.8	98.2	99.9	101.5	87.8	89.7	93.4	96.9	102.4
Percent Change - Year Ago	4.6	4.5	4.7	3.0	3.1	4.1	4.8	5.5	2.8	2.1	4.2	3.7	5.7
New Mortgage Commitments ($ billions)	154.3	144.7	155.2	164.8	169.0	174.0	183.2	192.9	64.8	163.4	174.2	165.7	195.4
Percent Change - Year Ago	-19.6	-11.8	-18.8	-20.2	9.5	20.3	18.0	17.1	8.1	152.1	6.6	-4.8	17.9
Mortgage Debt Outstanding ($ billions)	1,988	2,064	2,143	2,223	2,302	2,382	2,302	2,252	1,629	1,752	1,962	2,263	2,249
Homeowners' Equity ($ billions)	2,710	2,754	2,783	2,795	2,822	2,858	2,901	2,951	2,336	2,519	2,701	2,814	2,981
Housing Inventory (millions)	91.3	91.7	92.0	92.4	92.7	93.1	93.4	93.8	88.5	89.6	91.1	92.5	94.0
Private Housing Starts (thousands)	1,662	1,641	1,654	1,693	1,718	1,743	1,846	1,886	1,056	1,704	1,792	1,702	1,895
Single-Family	981	1,004	1,020	1,047	1,084	1,120	1,164	1,188	663	1,066	1,100	1,068	1,199
Percent of Total	59.0	61.2	61.7	61.8	63.1	64.2	63.1	63.0	62.8	62.6	61.3	62.7	63.3
Multi-Family	682	637	634	646	633	623	682	699	394	637	692	634	696
Percent of Total	41.0	38.8	38.3	38.2	36.9	35.8	36.9	37.0	37.2	37.4	38.7	37.3	36.7
Mobile Home Shipments (thousands)	294	295	303	299	302	293	302	305	240	296	295	299	308
Rental Vacancy Rate (%)	6.0	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.3	5.6	5.7	5.6	5.5
Unsold New Homes (% of sales)	54.1	58.2	54.2	50.2	49.9	49.9	49.1	46.2	65.2	43.0	51.2	51.1	46.5
Office Vacancy Rate (%)<1>	11.5	11.1	10.7	10.4	10.1	9.9	9.7	9.5	8.0	11.7	12.3	10.3	9.5
Industrial Vacancy Rate (%)<1>	4.4	4.2	4.0	3.9	3.8	3.8	3.7	3.7	4.4	4.9	4.5	3.9	3.6
New Commercial Building Construction (% Ch Value)	13.2	-5.2	-0.2	3.7	4.6	11.9	18.7	18.4	9.0	-4.2	33.7	5.6	13.3
New Industrial Building Construction (% Ch Value)	13.0	22.6	23.4	18.9	7.8	5.9	7.7	12.0	2.5	-25.7	12.8	17.5	11.0
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-8%)	4.6	0.7	4.1	5.7	6.4	6.9	6.4	6.5	6.6	11.1	6.5	4.4	6.4
M1 Velocity (% change)	1.0	5.2	2.1	-0.8	-2.1	0.5	1.5	3.0	-2.6	-3.1	4.0	1.5	1.2
M2 (% change)(FED Target 6-9%)	6.4	6.5	6.4	5.9	8.1	8.7	8.1	7.6	9.5	12.6	7.5	6.7	7.8
M2 Velocity (% change)	-0.7	-0.6	0.0	-1.0	-3.7	-1.2	-0.1	2.0	-5.3	-4.[illegible]	3.0	-0.7	0.0
Monetary Base (% change)	6.3	3.7	6.3	5.7	5.1	4.9	5.7	6.9	6.9	9.5	8.1	5.6	5.9
Flow of Funds													
Supply (total)	453	451	448	440	426	433	441	469	212	280	427	437	460
Personal Savings	164	161	164	156	146	152	161	168	136	118	156	154	167
Savings Rate	6.3	6.1	6.1	5.7	5.3	5.4	5.6	5.8	6.2	5.0	6.0	5.6	5.7
Net Business Savings	116	115	111	109	102	98	92	96	29	76	113	105	95
State + Local Govt. Savings	46	47	48	48	47	48	51	54	33	44	50	48	55
Foreign Funds(current account deficit)	127	129	125	127	130	135	137	141	13	42	108	129	144
Demand (total)	389	393	425	242	334	435	485	245	165	325	406	359	414
Consumer Installment Debt(net change)	70	43	33	19	21	22	23	28	19	40	69	24	31
Commercial+Industrial Loans(net change)	58	5	4	2	8	13	29	32	22	-2	43	7	40
Home Mortgage Debt(net change)	128	90	100	105	103	108	108	109	-6	96	117	104	112
Federal Deficit	133	256	288	117	201	291	324	76	131	190	176	224	231
Trade-Weighted Exchange Rate	1.119	1.128	1.104	1.086	1.065	1.044	1.025	1.005	0.988	1.024	1.091	1.075	0.998
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	14.7	13.9	13.5	13.3	12.9	13.0	13.0	13.0	17.2	13.9	14.1	13.2	13.0
Real Mortgage Rate	11.0	10.1	9.3	9.6	9.1	8.3	8.2	8.1	12.9	10.2	10.3	9.1	8.0
1 Year ARM (without buy-down)	13.5	11.9	11.0	10.7	10.7	10.8	11.1	10.9	14.0	11.3	12.6	10.8	11.2
Real Mortgage Rate	9.8	8.2	6.8	7.0	6.9	6.1	6.3	6.0	9.7	7.5	8.8	6.7	6.2
Corporate Bond Rate (AAA)	13.0	12.5	12.1	11.8	11.6	11.5	11.5	11.6	13.8	12.0	12.8	11.7	11.7
Government Bond Rate	12.8	11.9	11.3	11.2	11.0	10.9	11.0	11.1	12.9	11.3	12.5	11.1	11.1
Real Government Bond Rate	9.1	8.1	7.1	7.5	7.2	6.2	6.2	6.2	8.7	7.6	8.7	7.0	6.1
Federal Funds Rate	11.4	9.6	8.7	8.6	8.8	9.1	9.7	9.5	12.3	9.1	10.3	8.8	10.0
3 Month Treasury Bill Rate	10.3	9.0	8.2	7.9	8.0	8.1	8.5	8.3	10.6	8.6	9.6	8.1	8.6
Real 3 Month T-Bill Rate	6.6	5.2	4.0	4.2	4.2	3.5	3.6	3.4	6.4	4.8	5.8	4.0	3.6
1 Year Treasury Bill Rate	11.8	10.2	9.3	9.0	9.0	9.1	9.4	9.2	12.3	9.6	10.9	9.1	9.5
Commercial Paper Rate	11.1	9.5	8.7	8.5	8.6	8.9	9.4	9.2	11.9	8.9	10.2	8.7	9.6
Rate on Money Market Fund Shares	11.3	9.6	8.8	8.6	8.7	9.0	9.6	9.4	12.1	9.0	10.3	8.8	9.8
Prime Rate	13.0	12.1	11.3	10.7	10.6	10.6	11.2	11.3	14.9	10.8	12.1	10.8	11.5

<1> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, and Dick Peach.

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

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Outlook for the Economy and Real Estate

Aggregate Economy

The sharp decline in interest rates over the past four months has breathed new life into the economic recovery. In its flash estimate the U.S. Department of Commerce estimates that real or inflation-adjusted Gross National Product (GNP) increased 2.8 percent during the fourth quarter of 1984, up from just 1.6 percent during the third quarter. This reacceleration of economic growth is evident in several key indicators of economic performance for November, such as the 0.4 percent increase in industrial production, the 1.3 percent increase in the index of leading indicators, and the increases in all categories of consumer spending.

While the rate of economic growth slowed dramatically during the second half of 1984, the risks that this slowdown marks the end of the expansion have been greatly reduced by the decline in interest rates. Aggregate demand for goods and services remains strong, however, much of that demand is being satisfied by imports. In fact, the increase in imports accounts for about half of the decline in GNP growth during the second half of 1984. Moreover, few of the imbalances in the economy which characterize the onset of a recession exist at this time. Inflation remains moderate with no sign of acceleration. The ratio of inventories to sales remains below historical averages. Unemployment remains high, keeping downward pressure on wages.

A slowing of the rate of growth of GNP is typical at this stage of an economic recovery. In fact the current slowdown has occurred about two quarters later than the average of six preceeding recoveries[1/]. The current slowdown has all the markings of a growth recession where the rate of economic growth remains positive but below the long-run trend growth rate (3 percent) for about four quarters. The economy then returns to fairly rapid growth but the rate of expansion remains below that which occurred prior to the growth recession. Since 1948 there have been three periods when the economy has followed this growth recession scenario.

The growth of the economy should remain sluggish (1.5 to 2 percent) during the first two quarters of 1985. Spending by consumers should remain fairly weak over this period as the ratio of consumer installment debt as a share of disposable income is now approaching its 1979 peak. The rate of personal savings will remain relatively high as consumers work down this debt burden. Further, with the dollar remaining very strong, a growing proportion of domestic spending will go toward imports, depressing domestic production. While housing starts should improve on a seasonally-adjusted annual rate basis due to the decline in interest rates, actual starts will remain fairly low until spring when home sales pick up and the current inventory of unsold homes is reduced. Growth in business investment should remain at modest levels over the near term as weaker sales have reduced business cash flow, forcing a growing number of firms to seek external financing to continue existing investment projects.

[1/] The 1980-81 recovery is not included in this comparison since it lasted just 5 quarters.

During the second half of 1985 overall growth should accelerate to the 3 percent level due to increases in residential investment and consumption spending. For all of 1985 real GNP should increase about 2 1/2 percent compared to 6.7 percent during 1984. The expansion should then continue through 1986 with continued growth of consumer spending and a recovery of business investment boosting overall growth to about 3 1/2 percent.

Employment and Inflation

Nonfarm payroll employment increased by 309,000 or 0.3 percent in December, a little less than November but still a healthy increase. However, due to an even larger increase in the labor force, the civilian unemployment rate rose 0.1 percentage points to 7.2 percent. As another indication of improvement, the average weekly hours worked increased 0.3 percent over the November level. Sluggish growth of the economy should cause the unemployment rate to rise above 7 1/2 percent by the end of 1985 as growth of the labor force exceeds growth in employment.

The brightest spot in the economic outlook is the continued moderate pace of inflation. In November the Consumer Price Index (CPI) rose just 0.2 percent compared to 0.4 percent in the previous two months due largely to smaller increases in food and transportation costs and stable or declining import prices. For all of 1985 the CPI should increase about 3 1/2 percent compared to 4.3 percent in 1984.

At this point there is very little likelihood of an increase in inflation in the near term. Good harvests around the world should keep food prices stable while oil prices are likely to fall 10 to 20 percent. However, by 1986 inflation should begin to accelerate as labor costs increase due to a combination of slower productivity growth and faster increases in labor compensation.

Monetary Policy and Interest Rates

The increase in interest rates over the first half of 1984 and the resulting slowdown of the economy have made it apparent that the policy stance adopted by the Federal Reserve Board (FED) last spring was inconsistent with its own growth targets for the monetary aggregates. During the first six months of 1984 the nation's basis money supply, M1, increased at a compound annual rate of 8.3 percent while from July through November it increased at a compound annual rate of just 1.4 percent. It now looks as though 1984 growth rates for both M1 and M2 will be at about the middle of their respective target growth rates whereas growth at the upper one-half of those target ranges would have been more appropriate.

Fortunately, weaker private credit demand along with a more accomodative monetary policy during the final quarter of 1984 have resulted in sharp declines in interest rates. From a peak of about 10 1/2 percent in August the rate on 3-month Treasury Bills has fallen to a little under 8 percent. Long-term rates (corporate bonds and fixed-rate mortgages) have declined about 1 percentage point.

TABLE 1
Selected Interest Rates

	Treasury Bills				Mortgage Commitment Rate	
	3 Months	6 Months	1 Year	AAA Corporate Bonds	Fixed Rate	Adjustable-Rate
Aug	10.47	10.61	11.82	12.87	15.00	12.89
Sept	10.38	10.50	10.52	12.66	14.90	12.88
Oct	9.85	10.05	10.00	12.54	14.70	12.85
Nov	8.67	8.90	9.06	12.31	14.09	12.42
Dec	8.18	8.46	8.64	12.15	13.82	12.16

Short-term interest rates should continue to trend downward during the first six months of 1985 due to the weakness of the economy and continued ease on the part of the FED. The yield on three month Treasury bills, currently at about 8 percent, could fall as low as 7 percent during the spring. However, as the economy rebounds in the second half of the year short-term rates should turn upward with the rate on 3-month Treasury bills back up to 8 percent or above by the beginning of 1986.

Long-term rates should trend downward over most of 1986 due to reduced private credit demands and to increasing acceptance by investors that inflation will remain modest for the foreseeable future. The effective commitment rate for 30-year, fixed-rate mortgage loans, which is currently about 13.8 percent, should decline another one percentage point over the next twelve months to 12 1/2 to 13 percent before leveling off during 1986.

Residential Real Estate Markets

Residential real estate markets are responding very quickly to the decline in mortgage interest rates. In November sales of existing single-family homes increased 9.1 percent to a seasonally adjusted annual rate of 2.89 million units. Single-family housing starts in November were at a seasonally adjusted annual rate of 966,000 units, virtually unchanged from the October level. In total the single-family market advanced 6.5 percent during the month. The decline in interest rates has provided a larger boost to the resale market since builder buydowns are now less attractive. The decline in mortgage rates boosted the NAR Affordability Index for November to 85.6 percent, the highest level since last June.

Both single-family resales and starts should continue to improve through both 1985 and 1986 as lower mortgage rates, higher incomes, and moderate increases in home prices boost the Affordability Index over the 90 percent level. For all of 1985 a total of nearly 3 million existing single-family homes should change hands while single-family starts should increase a little over six percent to 1.17 million units. In 1986 single-family resales should increase to 3.1 million units while single-family starts level off at 1.17 million units.

Starts of new multi-family residential units should increase a modest 1 percent in 1985 to about 680,000 units and then rise about 7 percent to 730,000 units in 1986. Multi-family units as a proportion of total housing starts have risen from 29.1 percent in 1978 to about 38 percent in 1984. This trend should continue as the affordability issue continues to boost demand for rental units and condominums in place of higher priced single-family units.

Commercial and Industrial Real Estate Markets

Residential construction in both 1983 and 1984 has created a corresponding demand for retail and warehouse space of about 480 million square feet during 1984 and 500 million square feet in 1985. Despite an oversupply of office space the level of contracts for new office space increased 7 percent to 300 million square feet in 1984. Contracting in this sector should decline to 240 million square feet in 1985. While representing a drop of 20 percent over 1984 this level still exceeds the estimated long-run demand of 200 million square feet per year of new office space. Contracts for new industrial buildings increased an estimated 45 percent in 1984 to 155 million square feet as manufacturers expand, modernize, and relocate their plant facilities. In 1985 contracts for new industrial buildings should increase 13 percent to 175 million square feet. Investment in all types of commercial and industrial real estate will be lower than otherwise would be the case due to uncertainty over tax reform. Serious tax reform proposals that have been introduced thus far are anti- investment and pro-consumption.

TABLE 2
Commercial and Industrial Building Contracts

	Stores and Other Commercial		Office Buildings		Industrial Buildings	
	millions of sq ft	percent change	millions of sq ft	percent change	millions of sq ft	percent change
Year						
1981	337	-11%	325	+15%	187	-13%
1982	245	-27%	261	-20%	118	-37%
1983	362	+48%	281	+ 8%	107	-37%
1984p	477	+32%	300	+ 7%	155	+45%
1985f	500	+ 5%	240	-20%	175	+13%

SOURCE:

Historical Data: DRI, Review of the U.S. Economy, December 1984.
Forecasts: National Association of Realtors

p = Preliminary
f = Forecast

Table 3

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:3	84:4	85:1	85:2	85:3	85:4	86:1	86:2	1982	1983	1984	1985	1986
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,695	3,748	3,799	3.847	3,895	3.952	4,022	4,098	3,069	3,305	3,660	3,873	4,146
Percent Change	5.6	5.9	5.5	5.2	5.1	6.0	7.3	7.7	3.8	7.7	10.8	5.8	7.0
Percent Change (without inflation)	1.6	2.7	1.6	2.1	2.4	2.7	3.2	3.4	-2.1	3.7	6.7	2.4	3.3
Consumption	0.7	3.6	3.8	3.1	2.7	2.6	2.9	3.2	1.4	4.8	5.3	3.3	3.0
Durables	-3.6	11.4	6.8	4.2	3.7	2.8	3.2	4.0	-0.3	12.1	12.9	5.4	3.8
Nondurables	-1.2	0.1	3.1	2.9	2.6	2.6	2.7	2.9	0.6	3.7	4.6	2.3	2.8
Services	3.8	3.8	3.2	2.8	2.4	2.6	3.0	3.2	2.5	3.4	3.3	3.3	3.0
Residential Investment	-4.5	-7.4	4.1	12.0	17.6	8.1	4.5	-1.1	-15.0	41.7	12.0	3.8	4.8
Nonresidential Investment	13.7	5.5	5.8	3.8	3.4	3.9	6.8	7.1	-4.7	2.5	19.6	6.7	6.0
Structures	2.0	3.6	7.2	2.4	2.1	4.5	12.3	10.8	0.2	-7.8	14.7	4.9	8.0
Equipment	18.6	6.3	5.2	4.3	3.8	3.7	4.9	5.7	-6.8	7.3	21.6	7.4	5.3
Exports	7.7	6.8	4.7	4.4	4.5	5.1	6.3	7.9	-7.8	-5.6	5.2	5.1	6.4
Imports	55.4	-6.1	6.9	6.8	6.6	6.0	5.4	5.4	1.3	7.6	29.2	9.1	5.8
Government Purchases	5.4	5.0	5.2	4.2	2.0	0.6	4.8	2.2	2.0	-0.3	3.4	5.1	2.5
Consumption (% of GNP)	64.8	64.9	65.3	65.4	65.5	65.5	65.4	65.4	65.1	65.8	64.9	65.4	65.2
Residential Investment (% of GNP)	3.7	3.6	3.6	3.7	3.8	3.8	3.9	3.8	2.6	3.5	3.7	3.7	3.8
Nonresidential Investment (% of GNP)	12.7	12.8	12.9	13.0	13.0	13.1	13.2	13.3	11.3	11.1	12.5	13.0	13.3
Structures (% of GNP)	3.5	3.5	3.5	3.5	3.5	3.5	3.6	3.7	3.6	3.2	3.4	3.5	3.7
Equipment (% of GNP)	9.3	9.3	9.4	9.5	9 5	9.5	9.6	9.6	7.7	7.9	9.0	9.5	9.7
Inventory Change ($ billions)	71.8	46.2	24.3	13.1	8.5	11.7	11.4	13.0	-26.1	-13.5	60.6	14.4	19.3
Mfg. Capacity Utilization Rate (%)	83	82	82	81	81	80	81	81	71	75	82	81	82
Auto Sales (millions of units)	10.3	10.4	10.8	10.8	10.7	10.7	10.6	10 7	8.0	9.2	10.5	10.7	10.7
Domestic (% of total)	77.3	72.5	77.2	77.0	74.0	72.9	72.6	72.4	72.3	74.0	76.3	75.3	71.9
Imported (% of total)	22.7	27.5	22.8	23.0	26.0	27.1	27.4	27.6	27.9	26.0	23.7	24.7	28.1
Manufacturing Industrial Production (% change)	6.8	-1.0	1.7	0.6	1.5	1.9	6.0	5.0	-8.5	7.8	11.2	2.0	4.3
Common Market	12.7	4.2	1.7	3.0	4.1	2.5	1.8	3.1	-1.4	0.8	3.2	3.3	2.7
Japan	7.1	4.1	9.2	4.1	4.5	0.6	2.4	2.5	0.4	3.5	10.6	5.9	2.6
Employment(millions)(civilian:household basis)	105.2	105.8	106.2	106.5	107.1	107.5	108.0	108.5	99.5	100.8	105.0	106.8	108 9
Percent Change	0.2	2.4	1.4	1.3	2.0	1.7	2.0	1.7	-0.9	1.3	4.1	1.8	2.0
Unemployment Rate (%) (civilian)	7.5	7.3	7.5	7.5	7.6	7.7	7.7	7.6	9.7	9.6	7.5	7.6	7.6
Personal Income per Household (average)<1>	38,924	39,476	39.942	40,272	40.569	41.055	41,671	42,357	33,653	35,415	38,532	40,460	42,736
Percent Change -- Year Ago (w/o inflation)	6.0	4.6	3.0	1.8	1.0	0.9	1.1	1.6	-0.5	1.5	5.3	1.7	1.9
Personal Taxes per Household (average)	7,028	7.159	7,235	7,301	7,359	7 468	7,510	7,671	6,434	6,478	6,955	7,341	7,752
Percent Change -- Year Ago (w/o inflation)	6.0	5.5	3.7	2.3	1.5	1.1	0.6	1.6	-2.2	-3.0	3.4	2.2	1.9
Percent of Personal Income	18.8	18.9	18.9	18.9	19.0	19.0	18.8	18.9	19.9	19.1	18.8	19.0	19.0
Disposable Income per Household (average)	31,897	32,317	32,707	32,971	33,209	33,587	34,161	34,686	27,219	28,938	31,578	33,119	34,984
Percent Change--Year Ago (w/o inflation)	5.8	4.4	3.0	1.7	1.0	1.0	1.3	1.7	-0.1	2.5	5.7	1.7	1.9
Household Interest Payments (% of total)	10.4	10.3	10.2	10.3	10.6	10.7	10.6	10.5	9.6	9.8	10.4	10.5	10.4
Net Worth Per Household (average)	78,659	80,154	81,377	82,678	83,545	85,293	86,932	89,417	66,105	73,840	77,715	83,223	90,653
Percent Change--Year Ago (w/o inflation)	1.1	2.8	4.0	4.5	3.0	3.2	3.5	4.6	-1.9	7.6	1.4	3.6	5.1
Consumer Price Inflation (CPI)	3.6	4.0	3.5	3.1	3.0	3.2	4.1	4.3	6.2	3.2	4.3	3.5	3.8
Gross National Product Inflation (GNP Deflator)	4.0	3.1	3.8	3.0	2.6	3.2	3.9	4.0	6.0	3.8	3.8	3.3	3.6
Personal Consumption Inflation	4.3	3.5	3.1	2.8	2.8	3.0	3.9	4.0	5.9	3.7	3.3	3.2	3.6
Residential Construction Inflation	4.5	0.8	1.9	2.5	2.7	3.1	4.7	5.4	3.0	1.7	3.9	2.9	4.3
Nonresidential Construction Inflation	1.7	1.6	2.3	2.5	3.1	3.5	5.1	6.0	4.9	-1.0	0.3	2.3	4.8
Producers Price Inflation (WPI)	-0.7	0.3	1.6	1.2	1.8	2.7	3.4	3.7	2.0	1.3	2.4	1.1	3.2
Compensation per Manhour (% change)	3.6	3.3	4.9	3.7	3.7	4.3	5.9	5.0	8.0	4.8	4.1	3.9	4.9
Productivity (% change)	-0.7	1.1	0.4	1.5	1.8	1.8	1.7	1.8	0.2	3.4	2.7	1.1	1.8
Unit Labor Cost (% change)	4.6	1.9	4.5	2.2	1.8	2.4	4.2	3.2	7.8	1.3	1.4	2.7	3.1
Unit Capital Cost (% change)	4.4	4.2	4.0	3.7	3.4	3.2	2.9	2.7	9.5	6.9	4.6	3.6	2.6
Before Tax Corporate Profits ($ billions)<2>	232	225	224	224	225	223	231	239	181	213	241	224	245
Corporate Tax Liability	91	88	87	86	87	86	93	98	76	86	96	86	102
After Tax Profits	142	137	137	138	139	137	137	140	105	127	145	138	143
Inventory Valuation Adjustment	0	0	-5	-6	-9	-13	-17	-18	-9	-11	-5	-8	-20
Capital Consumption Adjustment	58	64	69	75	79	85	86	89	3	33	55	77	89
Profits from Current Production (with IVA, CCA)	200	201	201	206	209	208	207	210	98	149	195	206	212
Adjusted for Inflation (84:3 base)	200	199	198	201	203	200	197	199	107	156	196	201	199
Percent Change - Year Ago	19.9	10.3	5.1	2.1	1.5	0.6	-0.3	-1.3	-14.6	46.0	25.9	2.3	-0.7
Per Unit of Output (% of GNP)	5.4	5.4	5.3	5.4	5.4	5.3	5.1	5.1	3.2	4.5	5.3	5.3	5.1
Effective Corporate Tax Rate (%)<2>	30	29	29	28	28	28	30	31	39	34	31	28	31
Federal Tax Receipts (Unified basis)	701	637	642	822	730	670	662	916	609	613	676	716	770
Percent of GNP	19.0	17.0	16.9	21.4	18.8	17.0	16.5	22.3	19.8	18.6	18.5	18.5	18.6
Federal Expenditures (Unified basis)	833	887	923	935	922	951	984	994	740	803	851	933	1,002
Percent of GNP	22.6	23.7	24.3	24.3	23.7	24.1	24.5	24.3	24.1	24.3	23.2	24.1	24.2
Surplus or Deficit (Unified basis)	-133	-250	-282	-113	-191	-281	-323	-79	-131	-190	-175	-217	-232
% of GNP	3.6	6.7	7.4	2.9	4.9	7.1	8.0	1.9	4.2	5.8	4.8	5.6	5.6
% of Personal Savings	80.8	156.4	181.4	77.2	139.3	203.1	218.3	52.4	97.8	158.1	111.9	150.3	154.0
% of Net Domestic Savings	40.1	76.9	88.0	36.0	62.0	91.9	101.6	24.3	67.3	80.0	54.4	69.5	71.1

<1> Includes personal contributions for social insurance

<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 4

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:3	84:4	85:1	85:2	85:3	85:4	86:1	86:2	1982	1983	1984	1985	1986
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	3,663	3,792	3,963	4,084	4,168	4,212	4,247	4,233	2,590	3,754	3,944	4,107	4,239
Percent Change -- Year Ago	-3.8	0.8	-5.2	-1.3	13.8	11.1	7.2	3.6	-14.8	44.9	5.1	4.1	3.2
Existing Single-Family Home Sales (thousands)	2,713	2,828	2,900	2,950	3,000	3,050	3,070	3,090	1,948	2,719	2,879	2,975	3,100
Percent Change - Year Ago	-2.1	2.6	-1.4	-2.9	10.6	7.9	5.9	4.8	-17.2	39.6	5.9	3.3	4.2
Dollar Volume (billions)	237.0	241.2	254.7	263.4	268.7	266.7	278.5	287.0	156.5	224.5	247.8	263.4	285.3
Existing Home Prices - Median ($1000's)	73.6	72.5	75.2	76.9	77.5	75.9	79 0	81.0	67.7	69.8	72.7	76.4	80.3
Percent Change - Year Ago	3.6	3.5	4.8	5.2	5.3	4.7	5.0	5.4	2.3	3.2	4.2	5.0	5.2
Monthly Mortgage Payment (P&I. 80%, 30 yr.)	702	654	647	647	642	629	664	682	754	633	667	641	682
Percent of Household Income	23	21	20	20	20	19	20	20	28	22	22	20	20
Private Housing Starts (thousands)	1.664	1,569	1,697	1,835	1,931	1,938	1,970	1,914	1,056	1,704	1,774	1,850	1.900
Percent Change - Year Ago	-6.6	-7.6	-13.8	-3.2	16 1	23.5	16.1	4.3	-3.7	61.3	4.1	4.3	2.7
Single-Family	979	995	1,096	1,169	1,204	1,198	1,213	1,178	663	1.066	1,097	1 167	1,174
Percent of Total	58.9	63.4	64.6	63.7	62.4	61.8	61.6	61.5	62.8	62.6	61.8	63.1	61.8
Multi-Family	684	575	601	665	727	740	757	736	394	637	677	683	726
Percent of Total	41.1	36.6	35.4	36.3	37.6	38.2	38.4	38.5	37.2	37.4	38.2	36.9	38.2
Mobile Home Shipments	294	299	303	314	340	335	341	336	240	296	296	323	340
New Single-Family Home Sales (thousands)	615	624	645	654	663	680	682	685	417	626	641	660	683
Percent Change - Year Ago	4.7	-7.1	-6.7	3.2	7.9	9.0	5.8	4.7	-4.3	50.1	2.3	3.1	3.4
New Home Prices - Median ($1000's)	80.7	80.4	80.9	81.5	82.2	83.0	84.0	85.3	69.3	75.5	79.9	81.9	85.9
Percent Change - Year Ago	3.9	5.9	3.8	1.3	1.9	3.2	3.9	4.6	0.7	8.9	5.9	2.5	4.9
New Home Prices--Mean ($1000's. Quality Adjusted)	94.9	94.4	95.2	95.6	96.8	96.8	98.2	99.3	87.8	89.7	93.4	96.1	100.2
Percent Change - Year Ago	4.6	4.7	4.6	2.4	2.0	2.5	3.2	3.9	2.8	2.1	4.2	2.8	4.3
NAR Affordability Index	84.1	85.9	89.5	91.7	91.7	97.3	91.8	92.2	68.4	82.0	85.8	92.6	92.2
New Mortgage Commitments ($ billions)	189.3	181.6	186.6	192.5	196 1	204.0	196.1	195.0	64.8	163.4	192.2	194.8	194.1
Percent Change - Year Ago	-1.4	10.7	-2.4	-6.8	3.6	12.3	5.0	1.3	8.1	152.1	17 6	1 4	-0.4
Mortgage Debt Outstanding ($ billions)	1 988	2,076	2 167	2,256	2,347	2,433	2,361	2 314	1,629	1,752	1,965	2 301	2,312
Homeowners' Equity ($ billions)	1,496	1,517	1.535	1,548	1,565	1,584	1,607	1,629	1,586	1,554	1,515	1,558	1,642
Housing Inventory (millions)	91.3	91.7	92.0	92.4	92.7	93.2	93.6	94.0	88.5	89.6	91.1	92.6	94.2
Rental Vacancy Rate (%)	6.0	5.6	5.6	5.6	5.6	5.6	5.6	5.5	5.3	5.6	5.7	5.6	5.5
Unsold New Homes (% of sales)	54.2	57.7	53.1	47.0	47.2	46.4	48.1	46.9	65.2	43.0	51.1	48.4	47.8
Office Vacancy Rate (%)<1>	11.5	11.1	10.7	10.4	10.1	9.9	9.7	9.5	8.0	11.7	12.3	10.3	9.5
Industrial Vacancy Rate (%)<1>	4.4	4.2	4.0	3.9	3.8	3.8	3.7	3.7	4.4	4.9	4.5	3.9	3.6
New Commercial Building Construction (% Ch Value)	7.3	19.5	8.2	1.2	-0.9	8.4	18.0	17.3	9.0	-4.2	34.8	10.3	11.1
New Industrial Building Construction (% Ch Value)	0.3	5.3	0.2	5.4	18.0	18.5	23.5	20.2	2.5	-25.7	10.0	6.4	20.9
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-8%)	4.6	1.4	5.4	5.7	4.8	5.0	6.2	5.9	6.6	11.1	6.5	4.6	5.7
M1 Velocity (% change)	0.9	4.4	0.1	-0.5	0.3	1.0	1.5	1.8	-2.6	-3.1	4.0	1.2	1.4
M2 (% change)(FED Target 6-9%)	6.4	8.9	7.0	7.0	6.2	6.3	7.1	7.6	9.5	12.6	7.7	7.1	7.0
M2 Velocity (% change)	-0.7	-2.8	-1.4	-1.7	-1.1	-0.3	0.7	0.2	-5.3	-4.4	2.9	-1.2	0.2
Monetary Base (% change)	6.5	2.7	7.9	5.2	4.5	4.3	5 2	6.0	6.9	9.5	8.0	5.7	5.4
Flow of Funds													
Sources (total:gross savings)	688	662	648	639	640	651	664	686	422	479	656	645	700
Private													
Personal Savings	164	160	155	146	137	138	148	150	136	118	155	144	150
Savings Rate	6.3	6.0	5.8	5.4	5.0	5.0	5.2	5.2	6.2	5.0	6.0	5.3	5.2
Gross Business Savings	525	530	533	542	549	553	557	568	388	454	517	544	574
Government													
Federal	-181	-185	-197	-208	-214	-215	-226	-223	-148	-179	-173	-209	-219
State and Local	48	48	50	49	52	51	58	60	33	44	51	51	61
Foreign (current account deficit)	132	109	106	109	116	124	127	131	13	42	105	114	134
Uses (total:gross investment)	663	641	629	629	639	654	671	689	415	472	639	638	704
Nonresidential Investment													
Equipment	284	289	293	297	301	306	312	319	208	223	275	299	325
Structures	151	153	157	159	161	164	171	178	142	130	149	160	181
Residential Investment	155	153	155	160	168	173	177	178	91	132	154	164	179
Inventory Investment	72	46	24	13	9	12	11	13	-26	-13	61	14	19
Value of the U.S. Dollar (Weighted by Trade) (Base=1967)	1.119	1.142	1.126	1.105	1.080	1.057	1.034	1.013	0.988	1.024	1.095	1.092	1.003
Percent Change	21.1	8.5	-5.6	-7.3	-8.5	-8.4	-8.4	-7.9	9.4	3.7	6.9	-0.3	-8.1
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	14.7	13.9	13.2	12.9	12.7	12.7	12 9	12.9	17.2	13.9	14.1	12.9	12.9
Real Mortgage Rate	10.7	10.8	9.4	9.9	10.1	9.5	9.0	8.9	12.9	10.2	10.4	9.7	8.8
1 Year ARM (without buy-down)	13.5	11.7	10.3	9.8	9.7	10.2	10.4	10.7	14.0	11.3	12.6	10.0	10.6
Real Mortgage Rate	9.5	8.6	6.5	6.9	7.1	6.9	6.5	6.7	9.7	7.5	8.9	6.8	6.5
Corporate Bond Rate (AAA)	13.0	12.4	11.6	11.4	10.9	11.0	10.8	10.8	13.8	12.0	12.7	11.2	10.7
Government Bond Rate	12.8	11.8	11.1	10.7	10.3	10.3	10.3	10.4	12.9	11.3	12.5	10.6	10.3
Real Government Bond Rate	8.9	8.6	7.3	7.7	7.6	7.1	6.4	6.4	8.7	7.6	8.8	7.4	6.2
Federal Funds Rate	11.4	9.2	7 7	7.5	7.8	8.5	9.1	9.4	12.3	9 1	10.2	7.9	9.4
3 Month Treasury Bill Rate	10.3	8.8	7.5	7.1	7.2	7.6	8.1	8.3	10.6	8.6	9.5	7.3	8.3
Real 3 Month T-Bill Rate	6.4	5.7	3.7	4.1	4.5	4.4	4.2	4.3	6.4	4.8	5.8	4.2	4.2
1 Year Treasury Bill Rate	11.8	10.0	8.6	8.1	8.0	8.5	8.7	9.0	12.3	9.6	10.9	8.3	8.9
Real 1 Year T-Bill Rate	7.8	6.9	4.8	5.2	5.4	5.2	4.8	5.0	8.0	5.8	7.2	5.1	4.8
Commercial Paper Rate	11.1	9.2	7.8	7.6	7.7	8.3	8.9	9 1	11.9	8.9	10.1	7.9	9.2
Rate on Money Market Fund Shares	11.3	9.3	7.9	7.7	7.8	8.5	9.0	9.3	12.1	9.0	10.3	8.0	9.3
Prime Rate	13.0	11.8	10.4	9.8	9.7	10.2	10.9	11.1	14.9	10.8	12.0	10.0	11.2

<1> Historical data courtesy of Coldwell Banker

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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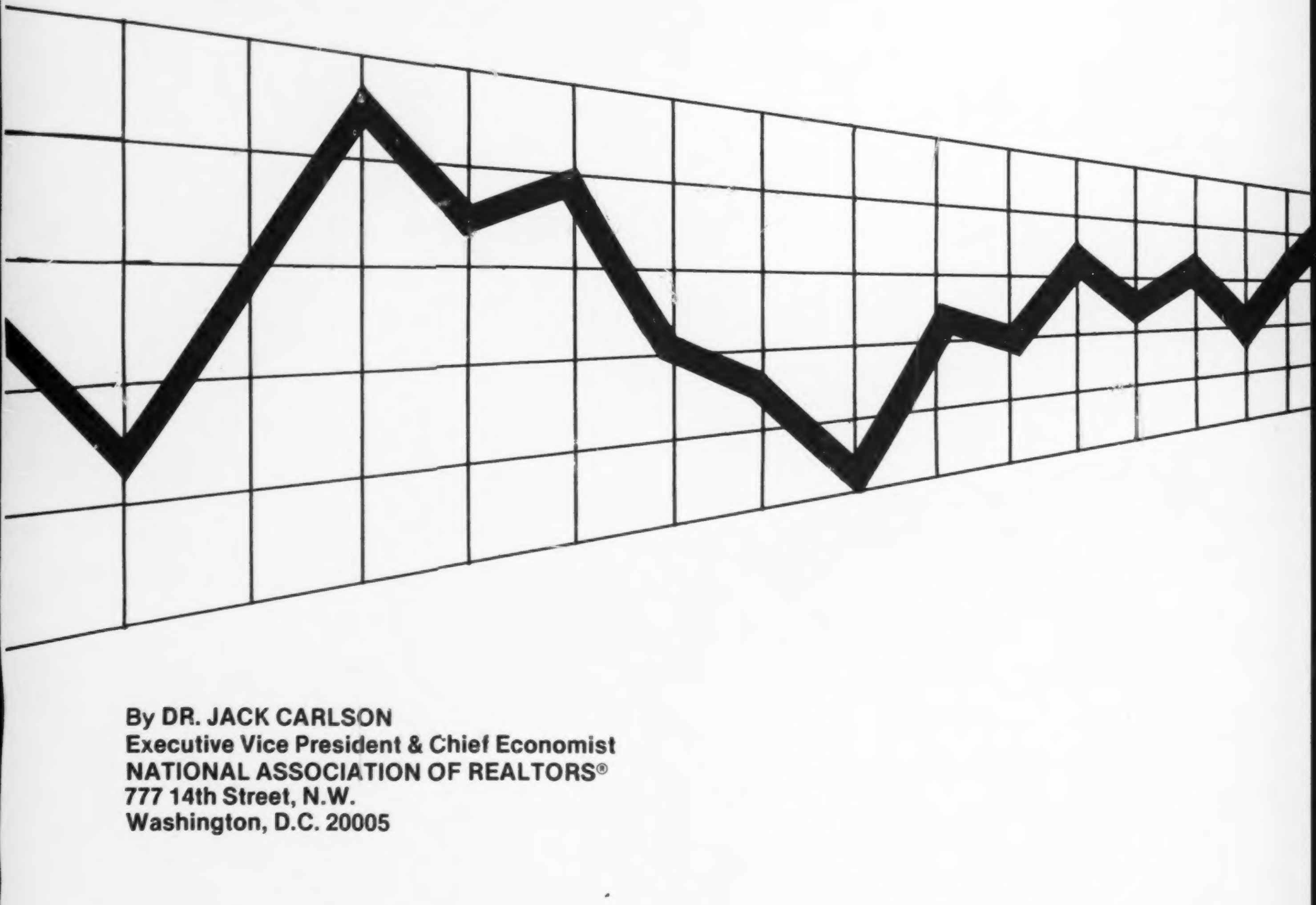
OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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Outlook for the Economy and Real Estate

Aggregate Economy

Stronger than expected gains in economic activity during the fourth quarter of 1984 have provided a strong footing on which to begin the new year. Lower interest rates and strong gains in personal income helped to boost consumer spending, while imports declined relative to exports during the fourth quarter of 1984 leading to an upward revision in real GNP growth to 3.9 percent. For all of 1984, real GNP growth reached 6.8 percent, its strongest showing since 1951.

Despite the re-acceleration in economic growth during the fourth quarter of 1984, a slight slowdown in real GNP is expected for 1985 with real growth reaching only 2.9 percent for the entire year. Evidence of this slowing trend can be found in the increase in the ratio of consumer debt to disposable income. This ratio, which is presently surpassing its previous peaks, should result in slower consumer spending in 1985 as consumers try to decrease their debt burden. Furthermore, growth in nonresidential investment, which reached 20 percent for all of 1984, is expected to slow to 7.5 percent for 1985 because of uncertanity about the fate of present investment incentives in the tax code. Finally, a strong dollar relative to other currencies will result in a further slowing in domestic production as imports continue to absorb a growing proportion of domestic demand. However, by 1986, a devaluation of the dollar and depleted inventories should pave the way for steady growth in real output of about 3.1 percent.

Longer term incentives for investment remain favorable. In response to the increase in import penetration into domestic markets, domestic businesses will be forced to become more efficient by improving their productivity and technology. In addition, as labor costs are expected to rise faster than the cost of equipment over the forecast interval, substitution away from labor and towards capital will become more cost effective, leading to more investment in residential and commercial structures and equipment.

Employment and Inflation

Employment improved for all of 1984 as total civilian employment increased 4.1 percent. Furthermore, the jobless rate which was 7.5 percent in 1984 was a marked improvement over the 9.6 percent unemployment rate in 1983. The unemployment rate is expected to remain around 7.3 percent for 1985 and increase slightly in 1986 as employment growth of two percent in 1986 is insufficient to absorb the growth in the labor force.

This most recent expansion has occurred with only modest gains in prices. Dispelling fears of future inflation the Consumer Price Index increased only four percent for all of 1984. Further evidence of moderating prices was seen in an increase of only 1.8 percent in producer prices, as falling commodity and energy prices contributed to the third smallest gain in the index in 20 years.

The outlook for inflation remains favorable as declines in oil prices as well as commodity prices continue to outweigh increases in cost of services through 1985. Producer prices are expected to increase just 0.8 percent for all of 1985, while consumer price inflation is expected to be only 3.4 percent.

By 1986, inflation is expected to accelerate slightly to 3.8 percent and climb to 4.1 percent by 1987 as the economy begins to heat up again.

Monetary Policy and Interest Rates

The Federal Reserve (FED), in trying to reverse the rapid decline in M1 during the middle of 1984, is expected to continue its accommodative stance adopted last fall. An accomodative monetary policy and low inflation should lead to further declines in interest rates for the first half of 1985. The prime leading rate charged by banks has been cut 250 basis points since September to 10-1/2 percent. However, in relation to the rate on 90 day CD's, which is presently 8 percent, the prime is still high. Historically, the spread between the prime and the CD rate has been 1-1/2 to 2 percent points, considerably less than it is now. Consequently, over the forecast interval the prime is expected to dip below 10 percent in 1985 before climbing to 11.4 percent by the end of 1986.

Convinced that inflation is well under control the FED has redirected its primary focus away from inflation and towards reducing unemployment. In fact, with producer price increases expected to remain below one percent for 1985, the FED will be sensitive to signals of disinflation and recession that may occur throughout the year.

Real Estate Markets

Activity in housing markets, after a shallow downturn, has begun to rebound as mortgage rates continue to trend downward. Existing single-family home sales reached 2.85 million units in December, 7.5 percent above the annual low of 2.65 million units in October. Housing starts, which recorded their first gain since September, increased 2.1 percent in December resulting in 1.744 million units started in 1984, the highest level since 1979.

Both existing home sales and housing starts are expected to trend upward through 1985 and 1986 as lower mortgage rates, modest inflation and increases in personal income are expected to boost the NAR Affordability Index. Effective commitment rates for 30 year fixed-rate mortgages are expected to drop to 12.7 percent by the middle of 1985, before increasing slightly to 13.2 percent by the end of 1986. However, the combination of increasing private credit demands and the existence of huge federal deficits will put upward pressure on interest rates in 1987 causing both resales and starts to decline below their 1984 levels.

Multi-family units owners are expected to lose the most from potential tax reform and face tough decisions in 1985. If either the Bradley-Gephardt or Treasury proposal were passed, the cost of owning multifamily units would rise dramatically thus dampening investment in this area. Consequently, supply would fall short of demand causing rents to increase sufficiently to attract investment in the long run.

Growth of construction of new commercial space should slow during 1985 and 1986 as apprehension about tax reform and an oversupply of office space dominates. For all of 1985, new commercial building construction should increase 12.4 percent compared to an increase of 38 percent in 1984. In contrast, the rate of growth of construction of new industrial buildings should increase to about 20 percent in 1985 from an increase of 13 percent in 1984.

Special Supplement
Macroeconomic Impacts of Tax Reform

At this time the three tax reform proposals receiving the most serious attention are the Kemp-Kasten "FAST" proposal (K-K), the Bradley-Gephardt "FAIR" proposal (B-G), and the Treasury Tax Reform Proposal (Treasury). Each of these proposals can be described as a modified flat tax. Each is an income tax as opposed to a consumption tax yet each moves toward the consumption tax concept by keeping or expanding current tax-free retirement saving (IRA and Keogh).

In order to achieve the objectives of simplicity, equity, and efficiency, each of these tax reform proposals makes the following changes to the current tax system:

1) expand both the personal and corporate tax base by repealing or limiting numerous deductions, exclusions and credits;

2) lower marginal tax rates; and

3) reduce both the steepness of the marginal tax rate schedule and the number of tax brackets.

All of these changes are made while keeping the total revenues raised by the tax system essentially unchanged (revenue neutrality), at least in the first year of enactment[1]. However, some very significant changes do occur in the distribution of the tax burden between household income classes and between the household and corporate sectors.

Current law has 14 tax brackets for joint returns with marginal personal tax rates ranging from 11 percent to 50 percent. The B-G proposal contains three tax brackets with marginal rates ranging from 14 percent to 30 percent. The K-K proposal contains just one marginal tax rate, 24 percent, but includes an exclusion from tax of 20 percent of wage income up to the maximum Social Security wage base which effectively causes marginal tax rates to range from 20 percent to 28 percent. The Treasury proposal also contains three brackets but with marginal rates ranging from 15 percent to 35 percent. Table 1 presents a comparison of marginal personal tax rates by size of adjusted gross income.

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[1] The B-G proposal repeals the indexation for inflation of brackets, personal exemptions, and the zero bracket amount or standard deduction and so raises more revenue that the current tax system in the out-years.

Table 1

Estimated Marginal Personal Tax Rates By Size of
Adjusted Gross Income
(Percent)

Adjusted Gross Income, 1986$ (Thousands)	Current Law	Bradley-Gephardt	Kemp-Kasten	Treasury
$0-14	7.4	8.9	10.1	5.2
$14-36	21.9	16.9	20.0	16.9
$36-57	31.4	25.2	22.0	25.5
$57-85	39.1	29.1	28.0	29.4
$85-142	44.9	30.0	26.0	35.0
$142+	50.0	30.0	24.0	35.0
Average	19.8	16.4	17.2	15.2

SOURCE: NATIONAL ASSOCIATION OF REALTORSß/Data Resources, Inc.

In return for lower marginal rates each of the proposals would broaden the personal tax base by repealing or limiting many personal deductions and credits and taxing sources of income not taxed under current law. For example, while all the proposals retain the deductability of mortgage interest on a principal residence, all of the proposals limit the deductability of other personal interest. Both K-K and B-G raise the threshold for deductibility of medical expenses from 5 percent to 10 percent of AGI. Treasury introduces a 2 percent of AGI threshold for deductibility of charitable contributions. All the proposals limit the deductibility of state and local income, property and sale taxes to some extent, with Treasury being the most extreme by repealing deductability of all such taxes. All the proposals eliminate the two-earner deduction and income averaging. One special feature of the B-G proposal is that regardless of the taxpayers income, all deductions are made at the lowest marginal tax rate of 14 percent.

Overall, the B-G proposal would increase the personal tax base about 31 percent compared to about 23 percent for K-K and 34 percent for Treasury. Table 2 presents estimates of the average tax rates under these proposals, or the percent of income paid as federal taxes. Note that due to base broadening, average rates do not decline very much relative to marginal rates. As a general rule, average rates fall for taxpayers at or below the median family income of about $25,000 and for taxpayers with incomes of $100,000 or more. For those taxpayers in between the decline in marginal rates does not offset the increase in the taxbase, boosting average tax rates.

Table 2

Estimated Average Personal Tax Rates By Size of Adjusted Gross Income

(Percent)

Adjusted Gross Income, 1986$ (Thousands)	Current Law	Bradley-Gephardt	Kemp-Kasten	Treasury
$0-14	4.0	3.0	1.5	1.6
$14-36	10.3	9.8	11.6	9.8
$36-57	13.8	13.1	14.7	14.6
$57-85	17.4	17.7	17.8	17.7
$85-142	21.0	21.1	19.8	22.4
$142+	37.2	24.8	20.3	27.2

Source: NATIONAL ASSOCIATION OF REALTORS®/Data Resources, Inc.

Each of the proposals makes similar changes to the taxation of income from business and capital. The B-G and Treasury proposals impose a flat corporate tax rate of 30 percent and 33 percent, respectively, while the K-K proposal has a graduated corporate tax rate with a maximum of 35 percent on income over $100,000. In return, each of the proposals repeals the current dividend exclusion and lengthens depreciation periods for all depreciable assets. For example, the B-G proposal lengthens the depreciation period for structures to 40 years while accelerating the depreciation method to 250 percent declining balance. The Treasury proposal applies a constant 3 percent to the inflation-indexed unrecovered basis of the structure. The K-K proposal, which has been recently revised, would extend the depreciation period for structures to 25 years and apply a constant 6 percent depreciation rate to the original basis with indexing of the resulting cost recovery allowance. In addition, both B-G and Treasury would repeal the current 60 percent capital gain exclusion with Treasury indexing the asset basis. K-K would give the option of a 40 percent exclusion with no indexing of the basis or no exclusion with full indexing. Finally, a special feature of the Treasury proposal is that all interest expense, even that incurred in a trade or business, would be inflation indexed. For example, at a 5 percent inflation rate, 45 percent of interest expense would not be deductable as a business expense.

The following tables present the results of macroeconomic simulations of these three tax reform proposals by the NATIONAL ASSOCIATION OF REALTORS® using the Data Resources, Inc. model of the U.S. economy[2]. As shown in Table 3 none of these proposals has a major impact on the overall growth rate of real GNP. However, this modest aggregate impact masks significant impacts on individual industries and sectors of the economy.

Table 3

Real GNP
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	-0.3	-0.5	-0.3	-0.3	-0.3	-0.2
K-K	-0.1	-0.1	0.1	0.2	0.3	1.0
Treasury	0.1	-0.1	-0.3	-0.2	0.2	0.5

As shown in Table 4, the B-G and K-K proposals would retain the current distribution of the federal tax burden between corporate and personal taxes. In contrast, the Treasury proposal shifts the tax burden from individuals to corporations.

Table 4

Federal Revenues by Source: 1986
(Percent of Total)

	Current Law	B-G	K-K	Treasury
Personal Tax	44.8	44.9	44.9	41.7
Corporate Tax	9.9	9.6	9.5	12.6
Indirect Business Tax	7.9	7.4	7.4	7.8
Social Insurance	37.4	38.1	38.2	37.9
Total	100.0	100.0	100.0	100.1

The increase in personal disposable income under the Treasury plan results in a sizeable boost of consumption above the baseline level despite a modest impact on overall GNP. In contrast, the B-G proposal results in a

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2/ These simulations are of the K-K and B-G proposals as introduced in the 98th Congress. Both proposals have been reintroduced in the 99th Congress with some significant changes to the K-K proposal. While these changes may affect some of the magnitudes attributed to the K-K proposal, they should not affect the relation of the K-K proposal to the B-G and Treasury proposals.

decline in consumption due not to a shift of GNP toward investment but from the fact that indexing is repealed which raises personal taxes and so reduces disposable income. K-K results in some increase in consumption in the out-years due to a higher GNP.

Table 5

Real Consumption
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	-0.2	-0.4	-0.4	-0.6	-0.9	-2.3
K-K	-1.2	-1.6	0.1	0.2	0.6	0.3
Treasury	0.4	0.6	0.4	0.4	0.4	0.2

Despite a decline in overall investment during a transition period both the B-G and K-K proposals result in an increase in overall investment in the out-years, enhancing productivity growth and real living standards. In contrast, the Treasury proposal results in a long-term decline in overall investment which reduces productivity and real living standards. All of the proposals result in significant shifts in the composition of investment.

Table 6

Real Investment
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	-1.2	-2.2	-1.4	-0.7	0.1	5.4
K-K	-0.1	-0.1	0.0	0.0	0.1	4.7
Treasury	-0.7	-3.3	-4.2	-3.7	-1.8	0.7

As shown in Tables 7, 8, and 9, under each of the proposals the single-family housing market is depressed during a three year transition period as markets adjust to the decline in home values. Home values fall due to the dilution in value of the mortgage interest deduction resulting from lower marginal tax rates. In the case of the Treasury proposal the decline in values is greatest due to the fact that property taxes are no longer deductable. After this transition period the level of single-family housing activity rises above the baseline as the decline in marginal tax rates results in declines in nominal interest rates. By 1995 mortgage commitment rates fall by 3 percentage points under B-G, 1.3 percentage points under K-K, and 2.2 percentage points under Treasury. The largest decline under B-G is due to the fact that in addition to reducing marginal tax rates B-G repeals indexing of tax brackets, exemptions, and the ZBA and so results in a much larger decline in the federal deficit than do the other proposals. The deficit reduction provided by K-K and Treasury is limited to declines in interest expense due to the decline in market interest rates. The decline in interest rates also helps to recap some of the decline in home value.

Table 7

Value of the Stock of Single-Family Homes
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	- 9.8	- 9.1	- 8.4	- 7.7	- 6.9	- 3.3
K-K	- 5.1	- 5.3	- 5.5	- 5.8	- 6.1	- 6.3
Treasury	-10.0	-10.2	-10.7	-11.2	-11.5	-10.5

Table 8

Mortgage Interest Rates
(Percentage point change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	-0.06	-0.16	-0.26	-0.47	-0.81	-3.00
K-K	-0.02	-0.06	-0.14	-0.23	-0.40	-1.32
Treasury	-0.21	-0.34	-0.56	-0.88	-1.22	-2.16

Table 9

Single-Family Housing Markets
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
Single-family housing starts						
B-G	- 9.6	- 5.2	- 1.1	0.5	3.2	14.6
K-K	- 5.2	- 2.2	0.5	1.5	3.2	1.8
Treasury	- 8.3	- 7.3	- 2.9	1.3	5.3	1.4

Single-family resales	1986	1987	1988	1989	1990	1995
B-G	-15.6	- 9.8	- 4.3	-1.0	3.4	19.5
K-K	- 7.8	- 3.4	0.5	2.0	3.9	2.5
Treasury	-14.4	-12.2	- 6.3	0.7	6.2	0.7

Each of the proposals reduces the rental cost of capital for structures to some degree through the decline in marginal tax rates and nominal interest rates and changes in capital gains taxation. The Treasury proposal results in the smallest decline in the rental cost of structures. In fact, barring reductions in interest rates the Treasury proposal increases the rental cost of structures somewhat since the reduction in depreciation is not offset by the decline in marginal tax rates.

Table 10

Rental Cost of Capital-Structures
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	-4.3	-6.3	-7.2	-7.4	-7.3	- 8.2
K-K	-8.8	-9.1	-9.1	-9.0	-9.4	-10.8
Treasury	-0.3	-0.1	-1.1	-2.2	-3.2	- 3.4

The decline in the rental cost of structures results in a proportional increase in investment in nonresidential structures. Multi-family starts decline during the transition period since a large proportion of multi-family units are built for the homeownership market.

Table 11

Multi-family Housing Starts
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	-8.7	-6.9	-4.9	-2.5	0.3	10.8
K-K	-3.7	-1.8	0.0	0.7	1.1	1.5
Treasury	-8.8	-7.2	-5.0	-0.8	1.4	-1.0

Real Investment in Nonresidential Structures
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	1.5	2.6	3.2	2.9	1.6	6.8
K-K	3.5	4.9	4.8	4.1	3.2	8.4
Treasury	0.3	-0.9	-2.2	-3.2	-3.6	0.7

In contrast, primarily through repeal of the investment tax credit all three proposals result in an increase in the rental cost of equipment, thereby eliminating the preferential treatment received by equipment under current law. The increase in the rental cost of equipment results in a decline in investment in equipment under all three proposals.

Table 12

Rental Cost of Equipment
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	15.3	13.7	12.9	12.6	12.7	12.1
K-K	10.9	10.6	10.4	10.0	9.3	7.7
Treasury	15.8	15.9	15.0	13.7	12.7	14.0

Investment in Nonresidential Equipment
(Percent change from baseline)

	1986	1987	1988	1989	1990	1995
B-G	-1.0	-3.2	-3.3	-2.5	-1.3	3.3
K-K	-0.5	-2.1	-2.3	-1.5	0.4	4.1
Treasury	-0.2	-4.3	-6.3	-6.2	-4.1	0.2

In comparing the three the K-K proposal appears to be most desireable since it provides additional investment incentives and so promotes more rapid growth of productivity and real living standards. In contrast, the Treasury proposal reduces investment incentives and so represents a reversal of the "supply-side" revolution of 1981. While B-G boosts investment in the out years this is done primarily through raising personal taxes to reduce the deficit and thereby reduce interest rates.

The behavior of interest rates is a critical factor in this evaluation. While it is true that reducing marginal tax rates would lower nominal interest rates, there is evidence that in today's market interest rates are determined by the inflow of funds from foreign investors who are totally exempt from U.S. taxes. To the extent that this is the case, none of those proposals would produce the decline in interest rates that is now expected.

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Table 13

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:4	85:1	85:2	85:3	85:4	86:1	86:2	86:3	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,753	3,810	3,860	3,909	3,968	4,035	4,106	4,180	3,305	3,661	3,887	4,147	4,441
Percent Change	6.4	6.3	5.4	5.1	6.2	6.9	7.3	7.4	7.7	10.8	6.2	6.7	7.1
Percent Change (without inflation)	3.9	2.6	2.3	2.5	2.8	3.2	3.5	3.7	3.7	6.8	2.9	3.1	3.0
Consumption	3.9	4.5	3.6	3.0	3.0	3.0	3.5	3.2	4.8	5.3	3.7	3.2	3.3
Durables	12.1	8.3	6.5	4.9	4.0	3.7	4.4	4.2	12.1	12.9	6.6	4.4	4.6
Nondurables	2.1	3.4	3.2	2.7	2.7	2.8	3.2	2.9	3.7	4.7	2.8	2.9	2.8
Services	2.5	4.0	3.0	2.5	2.8	2.9	3.4	3.1	3.4	3.2	3.3	3.0	3.1
Residential Investment	-2.0	-1.7	10.9	19.6	5.1	3.0	-3.4	-5.8	41.7	12.4	3.3	2.9	-3.7
Nonresidential Investment	11.1	4.4	4.0	4.0	3.7	3.8	5.6	6.5	2.5	20.0	7.5	4.7	6.9
Structures	18.4	2.5	2.0	2.4	1.4	2.0	2.6	2.7	-7.8	15.7	6.1	2.2	4.2
Equipment	8.4	5.2	4.8	4.6	4.6	4.5	6.8	7.9	7.3	21.7	8.1	5.6	7.9
Exports	-3.2	5.1	4.0	3.9	4.2	5.7	7.7	8.3	-5.6	4.6	3.0	6.0	7.7
Imports	-26.6	12.5	8.6	7.9	7.6	6.2	6.2	5.9	7.6	27.1	6.2	6.8	5.8
Government Purchases	6.6	4.4	4.5	1.5	2.9	3.6	2.5	0.4	-0.3	3.5	5.3	2.6	2.4
Consumption (% of GNP)	64.8	65.1	65.3	65.4	65.4	65.4	65.4	65.3	65.8	64.8	65.3	65.3	65.5
Residential Investment (% of GNP)	3.6	3.6	3.6	3.8	3.8	3.8	3.7	3.6	3.5	3.7	3.7	3.7	3.4
Nonresidential Investment (% of GNP)	12.9	13.0	13.1	13.1	13.1	13.2	13.2	13.3	11.1	12.5	13.1	13.3	13.8
Structures (% of GNP)	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.5	3.2	3.5	3.6	3.5	3.6
Equipment (% of GNP)	9.4	9.4	9.5	9.5	9.6	9.6	9.7	9.8	7.9	9.0	9.5	9.7	10.2
Inventory Change ($ billions)	31.1	21.5	9.5	5.8	7.1	9.1	10.6	18.5	-13.5	56.8	11.0	14.0	-6.6
Mfg. Capacity Utilization Rate (%)	82	82	82	82	81	81	82	82	75	82	82	82	83
Auto Sales (millions of units)	10.2	10.8	10.6	10.8	10.8	10.8	10.8	10.9	9.2	10.4	10.7	10.8	11.1
Domestic (% of total)	72.9	77.0	77.1	74.4	73.4	73.1	72.8	71.9	74.0	76.4	75.5	72.4	70.5
Imported (% of total)	27.1	23.0	22.9	25.6	26.6	26.9	27.2	28.1	26.0	23.6	24.5	27.6	29.5
Manufacturing Industrial Production (% change)	0.1	5.4	1.8	2.1	1.9	4.5	3.8	5.1	7.8	11.3	3.5	3.5	4.9
Common Market	2.3	2.5	1.9	3.8	2.4	2.2	3.2	2.1	0.8	3.1	2.9	2.7	2.0
Japan	12.6	2.7	4.0	4.4	0.5	2.0	2.1	4.0	3.5	11.1	5.8	2.4	1.9
Employment(millions)(civilian:household basis)	106.0	106.4	106.8	107.4	107.9	108.4	108.8	109.4	100.8	105.0	107.1	109.1	111.3
Percent Change	2.5	1.7	1.5	2.2	1.8	1.9	1.6	2.3	1.3	4.1	2.0	1.9	1.9
Unemployment Rate (%) (civilian)	7.2	7.2	7.3	7.3	7.4	7.4	7.4	7.4	9.6	7.5	7.3	7.4	7.3
Personal Income per Household (average)<i>	39,504	39,998	40,304	40,611	41,166	41,776	42,495	43,071	35,415	38,539	40,520	42,799	45,462
Percent Change -- Year Ago (w/o inflation)	4.9	3.5	2.2	1.5	1.2	1.3	1.9	2.2	1.5	5.4	2.1	2.0	2.1
Personal Taxes per Household (average)	7,156	7,236	7,306	7,361	7,484	7,552	7,710	7,830	6,478	6,954	7,347	7,775	8,344
Percent Change -- Year Ago (w/o inflation)	5.6	4.0	2.6	1.8	1.4	1.2	2.2	2.7	-3.0	3.5	2.4	2.3	3.2
Percent of Personal Income	18.9	18.9	18.9	18.9	19.0	18.9	19.0	19.0	19.1	18.8	18.9	19.0	19.2
Disposable Income per Household (average)	32,348	32,762	32,998	33,250	33,681	34,225	34,785	35,241	28,938	31,586	33,173	35,024	37,118
Percent Change--Year Ago (w/o inflation)	4.7	3.5	2.2	1.6	1.3	1.4	2.0	2.2	2.5	5.8	2.1	2.0	1.8
Household Interest Payments (% of total)	10.4	10.3	10.4	10.7	10.8	10.7	10.7	10.7	9.8	10.4	10.5	10.6	9.9
Net Worth Per Household (average)	79,956	81,921	83,722	84,854	86,622	87,880	89,644	90,972	73,840	77,666	84,280	90,308	97,138
Percent Change--Year Ago (w/o inflation)	2.7	4.9	6.1	4.8	5.1	4.0	3.7	3.6	7.6	1.4	5.2	3.6	3.4
Consumer Price Inflation (CPI)	3.9	3.3	2.9	3.0	3.4	4.0	4.1	4.2	3.2	4.2	3.4	3.8	4.1
Gross National Product Inflation (GNP Deflator)	2.4	3.6	3.1	2.6	3.3	3.6	3.6	3.6	3.8	3.7	3.1	3.4	4.0
Personal Consumption Inflation	2.6	2.8	2.6	2.7	3.2	3.7	3.9	3.9	3.7	3.2	2.9	3.5	4.1
Residential Construction Inflation	2.0	1.9	2.8	2.8	3.3	4.3	4.9	4.8	1.7	4.0	3.2	4.0	4.8
Nonresidential Construction Inflation	-1.1	1.5	2.0	2.6	3.3	4.4	4.8	4.8	-1.0	0.2	1.4	4.0	4.9
Producers Price Inflation (WPI)	0.4	1.1	0.2	1.3	2.5	3.3	3.4	3.9	1.3	2.4	0.8	2.9	4.1
Compensation per Manhour (% change)	3.3	5.6	4.1	4.1	4.9	6.0	5.2	5.2	4.8	4.1	4.3	5.1	5.3
Productivity (% change)	1.1	1.4	1.6	1.9	1.6	1.3	1.5	1.7	3.4	2.7	1.4	1.6	1.8
Unit Labor Cost (% change)	1.9	4.1	2.4	2.1	3.2	4.6	3.6	3.4	1.3	1.4	2.8	3.5	3.4
Unit Capital Cost (% change)	4.3	4.1	3.8	3.4	3.0	2.7	2.4	2.2	6.9	4.6	3.6	2.4	1.9
Before Tax Corporate Profits ($ billions)<2>	230	228	229	232	231	239	241	249	213	242	230	245	269
Corporate Tax Liability	89	88	87	88	88	95	97	101	86	96	88	98	111
After Tax Profits	141	141	143	144	143	144	145	148	127	146	143	146	158
Inventory Valuation Adjustment	-2	-3	-2	-6	-12	-16	-17	-19	-11	-6	-6	-18	-21
Capital Consumption Adjustment	66	70	76	81	86	88	90	92	33	56	78	91	87
Profits from Current Production (with IVA, CCA)	205	208	216	219	218	216	218	221	149	196	215	219	224
Adjusted for Inflation (84:3 base)	203	205	212	213	210	206	207	207	156	197	210	206	203
Percent Change - Year Ago	12.7	8.9	7.4	6.6	3.1	0.8	-2.4	-2.7	46.0	26.6	6.4	-1.6	-1.5
Per Unit of Output (% of GNP)	5.5	5.5	5.6	5.6	5.5	5.4	5.3	5.3	4.5	5.4	5.5	5.3	5.1
Effective Corporate Tax Rate (%)<2>	29	28	28	28	28	30	30	31	34	31	28	30	32
Federal Tax Receipts (Unified basis)	637	641	822	731	674	664	915	761	613	676	717	767	832
Percent of GNP	17.0	16.8	21.3	18.7	17.0	16.4	22.3	18.2	18.6	18.5	18.5	18.5	18.7
Federal Expenditures (Unified basis)	888	931	937	923	956	985	994	1,000	803	851	937	1,001	1,082
Percent of GNP	23.7	24.4	24.3	23.6	24.1	24.4	24.2	23.9	24.3	23.2	24.1	24.1	24.4
Surplus or Deficit (Unified basis)	-250	-290	-114	-191	-282	-321	-78	-239	-190	-175	-220	-234	-249
% of GNP	6.7	7.6	3.0	4.9	7.1	8.0	1.9	5.7	5.8	4.8	5.6	5.6	5.6
% of Personal Savings	150.4	181.8	78.2	140.0	202.8	218.8	51.6	161.3	158.1	110.4	150.7	157.0	169.1
% of Net Domestic Savings	73.5	86.4	34.9	59.4	88.8	98.8	23.8	72.9	80.0	53.6	67.4	71.7	75.9

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 14

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:4	85:1	85:2	85:3	85:4	86:1	86:2	86:3	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	3,755	3,941	4,128	4,224	4,236	4,256	4,203	4,201	3,754	3,934	4,132	4,203	3,828
Percent Change -- Year Ago	-0.2	-5.7	-0.3	15.3	12.8	8.0	1.8	-0.5	44.9	4.8	5.0	1.7	-8.9
Existing Single-Family Home Sales (thousands)	2,773	2,876	2,980	3,050	3,095	3,095	3,100	3,111	2,719	2,866	3,000	3,100	2,800
Percent Change - Year Ago	0.6	-2.2	-1.8	12.4	11.6	7.6	4.0	2.0	39.6	5.4	4.7	3.3	-9.7
Dollar Volume (billions)	238.8	251.4	264.0	270.4	268.8	274.8	280.5	283.2	224.5	247.2	263.6	278.9	260.8
Existing Home Prices - Median ($1000's)	72.4	74.2	75.8	76.3	75.1	77.0	78.7	79.4	69.8	72.7	75.4	78.3	81.6
Percent Change - Year Ago	3.4	3.5	3.6	3.7	3.7	3.8	3.9	4.1	3.2	4.2	3.6	4.0	4.2
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	662	639	633	633	627	658	677	683	633	669	633	674	715
Percent of Household Income	21	20	20	20	19	20	20	20	22	22	20	20	20
Private Housing Starts (thousands)	1,559	1,709	1,834	1,931	1,925	1,901	1,835	1,799	1,704	1,771	1,850	1,820	1,701
Percent Change - Year Ago	-8.2	-13.1	-3.2	16.1	23.5	11.2	0.0	-6.8	61.3	4.0	4.4	-1.6	-6.6
Single-Family	1,012	1,098	1,183	1,210	1,176	1,197	1,138	1,124	1,066	1,102	1,167	1,136	1,059
Percent of Total	64.9	64.3	64.5	62.7	61.1	63.0	62.0	62.5	62.6	62.2	63.1	62.4	62.3
Multi-Family	546	611	651	721	749	704	697	675	637	670	683	684	642
Percent of Total	35.1	35.7	35.5	37.3	38.9	37.0	38.0	37.5	37.4	37.8	36.9	37.6	37.7
Mobile Home Shipments	297	308	323	352	353	351	345	337	296	296	334	341	331
New Single-Family Home Sales (thousands)	620	641	647	663	669	671	678	687	626	639	655	678	617
Percent Change - Year Ago	-7.7	-7.3	2.1	8.6	7.9	4.6	4.9	3.6	50.1	2.0	2.5	3.6	-9.0
New Home Prices - Median ($1000's)	81.2	81.7	82.4	83.2	84.0	85.0	86.1	87.3	75.5	80.2	82.8	86.7	91.2
Percent Change - Year Ago	7.0	4.9	2.4	2.5	3.4	4.0	4.5	4.9	8.9	6.3	3.3	4.7	5.1
New Home Prices--Mean ($1000's, Quality Adjusted)	94.6	95.5	96.0	97.2	97.1	98.6	99.7	101.4	89.7	93.5	96.5	100.4	105.2
Percent Change - Year Ago	4.9	4.9	2.8	2.4	2.6	3.2	3.9	4.3	2.1	4.3	3.2	4.0	4.8
NAR Affordability Index	85.6	87.4	91.6	90.6	90.4	91.0	92.3	89.7	82.0	85.7	91.5	92.3	92.3
New Mortgage Commitments ($ billions)	170.9	177.8	187.7	190.5	201.4	191.6	191.6	180.8	163.4	186.9	189.4	187.0	176.5
Percent Change - Year Ago	4.2	-7.0	-9.1	6.5	17.9	7.7	2.0	-5.1	152.1	14.4	1.3	-1.2	-5.6
Mortgage Debt Outstanding ($ billions)	2,070	2,166	2,259	2,355	2,444	2,535	2,619	2,706	1,752	1,962	2,306	2,661	2,985
Homeowners' Equity ($ billions)<1>	1,478	1,492	1,503	1,519	1,536	1,557	1,575	1,596	1,554	1,505	1,512	1,586	1,668
Housing Inventory (millions)	91.7	92.0	92.4	92.7	93.2	93.6	94.0	[illegible]	89.6	91.1	92.6	94.2	95.7
Rental Vacancy Rate (%)	5.6	5.6	5.6	5.6	5.5	5.5	5.5	5.5	5.6	5.7	5.6	5.5	5.5
Unsold New Homes (% of sales)	55.6	53.5	49.1	50.0	49.4	53.4	53.3	55.4	43.0	50.6	50.5	53.1	49.6
Office Vacancy Rate (%)<2>	11.1	10.7	10.4	10.1	9.9	9.7	9.5	9.4	11.7	12.3	10.3	9.5	9.3
Industrial Vacancy Rate (%)<2>	4.2	4.0	3.9	3.8	3.8	3.7	3.7	3.6	4.9	4.5	3.9	3.6	3.4
New Commercial Building Construction (% Ch Value)	61.3	-1.9	-2.0	-1.0	0.8	0.2	2.9	-2.9	-4.2	37.7	12.4	0.3	2.2
New Industrial Building Construction (% Ch Value)	54.8	16.0	9.7	18.4	12.3	17.8	12.5	20.5	-25.7	13.3	19.5	15.8	21.0
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	1.9	9.5	6.2	4.8	4.3	5.2	5.8	6.4	11.1	6.6	5.7	5.4	5.3
M1 Velocity (% change)	4.4	-2.9	-0.7	0.3	1.7	1.7	1.4	1.0	-3.1	3.9	0.4	1.2	1.7
M2 (% change)(FED Target 6-8.5%)	9.7	12.1	7.5	5.1	4.8	5.7	6.9	7.6	12.6	7.7	8.4	6.2	6.9
M2 Velocity (% change)	-3.0	-5.2	-1.9	0.0	1.3	1.2	0.3	-0.1	-4.4	2.9	-2.1	0.5	0.2
Monetary Base (% change)	5.0	10.7	3.8	3.9	4.9	5.1	6.0	5.9	9.5	8.1	6.4	5.2	6.0
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	656	650	646	651	662	675	696	713	479	654	652	702	743
Private													
Personal Savings	166	160	146	137	139	147	152	148	118	157	145	150	147
Savings Rate	6.3	5.9	5.4	5.0	5.0	5.2	5.2	5.0	5.0	6.1	5.3	5.1	4.7
Gross Business Savings	534	543	555	563	566	571	579	589	454	518	557	584	621
Government													
Federal	-200	-205	-209	-214	-217	-224	-222	-220	-179	-176	-211	-222	-237
State and Local	52	53	52	55	53	56	55	57	44	52	53	55	61
Foreign (current account deficit)	104	100	102	110	121	126	132	138	42	103	108	135	151
Uses (total:gross investment)	636	632	631	643	655	669	682	702	472	637	640	692	730
Nonresidential Investment													
Equipment	291	296	300	305	311	317	325	335	223	276	303	330	371
Structures	158	159	161	163	165	167	170	173	130	150	162	172	188
Residential Investment	155	155	161	169	173	176	176	176	132	154	164	176	177
Inventory Investment	31	21	10	6	7	9	11	19	-13	57	11	14	-7
Value of the U.S. Dollar (Weighted by Trade) (Base=1967)	1.143	1.159	1.129	1.105	1.082	1.062	1.044	1.027	1.024	1.095	1.119	1.036	0.981
Percent Change	8.9	5.6	-9.8	-8.5	-7.8	-7.2	-6.7	-6.3	3.7	6.9	2.2	-7.4	-5.3
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year Fixed-Rate	14.1	13.2	12.8	12.7	12.8	13.1	13.2	13.2	13.9	14.2	12.9	13.2	13.4
Real Mortgage Rate	11.7	9.6	9.7	10.1	9.5	9.5	9.6	9.6	10.2	10.6	9.8	9.4	9.5
1 Year ARM (without buy-down)	11.7	10.1	9.8	9.8	10.3	10.7	10.8	10.7	11.3	12.6	10.0	10.8	11.5
Real Mortgage Rate	9.3	6.5	6.8	7.3	7.0	7.1	7.2	7.0	7.5	9.1	6.9	7.0	7.5
Corporate Bond Rate (AAA)	12.3	11.5	11.2	10.7	10.9	10.6	10.9	10.5	12.0	12.7	11.1	10.8	10.9
Government Bond Rate	11.8	11.0	10.5	10.1	10.3	10.2	10.4	10.1	11.3	12.5	10.4	10.2	10.5
Real Government Bond Rate	9.4	7.4	7.4	7.5	7.0	6.6	6.7	6.4	7.6	8.9	7.3	6.4	6.5
Federal Funds Rate	9.3	7.6	7.5	7.9	8.6	9.4	9.5	9.5	9.1	10.2	7.9	9.5	10.5
3 Month Treasury Bill Rate	8.8	7.2	7.0	7.2	7.6	8.2	8.3	8.3	8.6	9.5	7.2	8.3	9.1
Real 3 Month T-Bill Rate	6.4	3.6	3.9	4.6	4.3	4.6	4.7	4.7	4.8	6.0	4.1	4.5	5.1
1 Year Treasury Bill Rate	10.0	8.4	8.1	8.1	8.6	9.0	9.1	9.0	9.6	10.9	8.3	9.1	9.8
Real 1 Year T-Bill Rate	7.6	4.8	5.1	5.6	5.3	5.4	5.5	5.3	5.8	7.4	5.2	5.3	5.8
Commercial Paper Rate	9.2	7.6	7.5	7.8	8.4	9.1	9.2	9.2	8.9	10.1	7.8	9.2	10.1
Rate on Money Market Fund Shares	9.3	7.6	7.6	7.9	8.6	9.2	9.4	9.3	9.0	10.3	7.9	9.4	10.3
Prime Rate	11.8	10.2	9.7	9.7	10.3	10.9	11.2	11.4	10.8	12.0	10.0	11.3	12.2

<1> Homeowners Equity has been adjusted to correspond to the Federal Reserve's Flow of Funds data.
<2> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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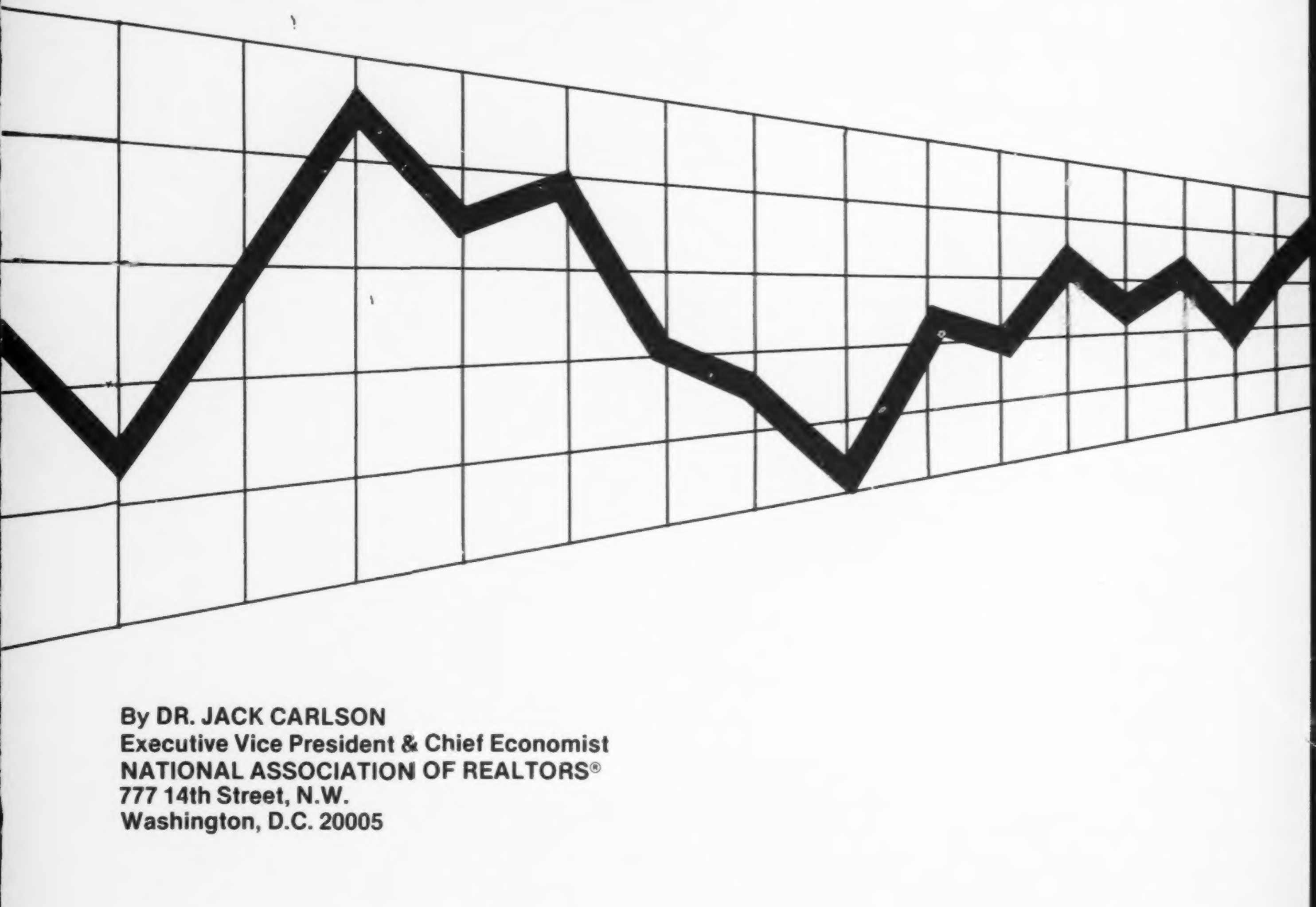
OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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MARCH 1985

Outlook for the Economy and Real Estate

Aggregate Economy

The economy continues to experience robust growth as evidenced by an upward revision in real GNP growth to 4.9 percent for the fourth quarter of 1984. The primary reason for the revision was an unexpected improvement in the trade balance. Unfortunately, further improvements in the trade balance are not expected. In fact the January trade deficit was the largest monthly deficit since September of 1984. This trend, which is expected to continue, will lead to increased import penetration in domestic markets holding down domestic output and employment.

The economy is expected to grow at a moderate pace of 3 to 3-1/2 percent for 1985 as lower interest rates continue to stimulate consumer demand for durables, including automobiles and housing. An indication of strong growth in consumer demand in the near term was an increase of 3.7 percent in household durable good orders in January. In the housing market, building permits for single family residential units have increased a strong 8.2 percent over the past three months. By the end of 1985, slower growth is expected as the combination of slower growth of money and credit by the Federal Reserve Board and mounting budget deficits cause interest rates to increase.

Just as consumer and investment demand led the recovery, a decline in these components by 1986 could lead to slower growth in output with real GNP growth reaching only 2 percent for the entire year. As growth in consumer debt continues to outstrip growth in disposable income, consumer spending will dampen as consumers try to reduce their debt burden. Furthermore, a key indicator of future business investment, non-defense capital good orders, plummetted 11.5 percent in January reflecting apprehension by investors that the Federal government will increase taxes on investment in equipment and structures. This was the sixth and largest decline in this indicator in the last eight months, underscoring less official support for investment and economic growth.

Other forms of fixed investment are also likely being diminished due to apprehension about tax reform. Potential investors in summer homes, apartments, warehouses, retail space and other areas potentially hard hit by tax reform are becoming hesitant about investing in these areas knowing that there could be a decline of 10 to 20 percent or more in the value of their investments if, for example, the Treasury Proposal were adopted.

Employment and Inflation

Although the unemployment rate increased in January to 7.4 percent, this 0.2 percentage point increase should not be interpreted as a deterioration in the employment situation. In fact, the entire increase in the January unemployment rate was due to a larger than normal influx of woman entering the ranks of the unemployed; a seasonal phenonmenon that usually occurs this time of the year as temporary jobs created during the holidays are abolished.

Overall, labor market conditions continued to improve in January as nonfarm payroll employment increased by 350,000 jobs while average weekly hours worked declined by 0.1 hours. Both of these indicate increased confidence by employers to hire new employees rather than asking current workers to increase their workload.

The employment outlook remains favorable as growth in employment is expected to outpace additions to the labor force, holding the unemployment rate to 7.2 percent for 1985. By 1986, however, unemployment could increase as economic activity begins to slow.

Inflation continues to remain well under control. The Consumer Price Index (CPI) increased a modest 0.2 percent in January while the Producer Price Index was virtually unchanged. The CPI is expected to increase just 3.2 percent during 1985 as oil prices continue to decline and the strong dollar continues to hold down the price of imports as well as the prices of domestic competitors. Also, unit labor costs are rising at modest levels due to deregulation, relatively low increases in wages and continued improvement in productivity.

Over the longer term inflation is expected to reaccelerate in 1986 and 1987 as productivity growth slows, leading to an overall increase in unit labor costs and prices of products and services.

However, the optimistic forecast for inflation is not without risk. A main deterrent to price increases has been the existence of a strong dollar relative to other currencies. Consequently, a significant decline in the dollar could renew inflationary pressures leading to a larger then expected acceleration in prices.

Monetary Policy and Interest Rates

In his recent report to the Senate Banking Committee, Federal Reserve Board (FED) Chairman Paul Volcker testified that the FED intends to return to a more neutral stance, becoming less accomodative then it had been during the last quarter of 1984. The FED's primary goal in 1985 will be to provide sufficient money and credit to fuel moderate economic growth while guarding against a resurgence of inflation. Because of the sensitivity of the FED to the record breaking strength of the dollar, the FED will be hesitant about actively pushing interest rates higher in fear that the dollar would soar to still higher levels.

The interest rate outlook remains mixed. Short-term interest rates are expected to trend upward through 1985 as private and public credit demands continue to mount. Long-term rates, on the other hand, should decline through the first half of 1985 reflecting the slow downward adjustment of inflation expectations. Long-term rates are then expected to level off by the end of 1985 before trending upward in 1986.

Real Estate Markets

Real estate markets continues to improve in response to declining interest rates. Existing home sales increased 4.5 percent in January reaching a seasonally-adjusted annual rate of 3 million units. As mortgage interest rates continue to trend downward through the first half of 1985 existing home sales are expected to reach the 3.3 million unit rate by mid-year. For all of 1985 total resales should reach 3.2 million units, falling off to 3 million units in 1986.

Overall, total housing starts increased 14.9 percent in January. However, the entire gain was due to a 76 percent increase in starts of structures with five or more units. This large increase in multifamily starts likely was compensating for the relatively low multifamily starts rate in December which was probably due to fears of increased federal taxes on rental properties and second homes following the announcement of the Treasury Department's proposed tax changes the previous month. Total housing starts are expected to trend upward in 1985. For the entire year housing starts are expected to total 1.8 million units before declining slightly to about 1.78 million units in 1986.

Affordability is expected to improve through 1985, primarily due to further declines in mortgage interest rates. The effective committment rate on 30 year, fixed rate mortgages is expected to decline to 13 percent by the second quarter of 1985, before increasing by the end of the year. This will boost the NAR Affordability Index to 89.1 percent for all of 1985. By 1986 mortgage rates could continue to trend upward resulting in a decline in the Affordability Index to 88.5 for the entire year.

The various components of nonresidential construction continue to exhibit different trends. New commercial construction put in place should begin to slow in 1985 due to a surplus of office space and apprehension about tax reform. For all of 1985 new commercial building construction should increase 13.6 percent. In 1986 new commercial building construction should actually decline 1.5 percent over the previous year.

Industrial construction, on the other hand, is expected to record strong gains through 1987. New industrial building construction should increase 15.8 percent in 1985 compared with 11.9 percent in 1984. By 1986, growth in new industrial building construction should reach 18.9 percent.

Special Supplement

The Current Recovery:
Was Consumption or Investment Responsible?

One of the strongest recoveries since 1950 is beginning to wind down with growth in real output surpassing the average of the six preceeding recoveries. Yet, there has been some confusion as to what has been the dominant force of the recovery - consumption or investment. The answer will differ depending on which type of analysis is used.

In observing the rate of growth of various components of GNP over the first eight quarters of the recovery it appears that growth in investment and not consumption has dominated the recovery. (Table 1) Using this analysis growth in gross private domestic investment of 27.5 percent for the first eight quarters of the current recovery has far exceeded the average of 13.5 percent over the six preceeding recoveries while growth in consumption remains only slightly above average. Most of the growth in investment has stemmed from strong growth in investment in nonresidential equipment while investment in structures has only marginally improved. Growth in investment in nonresidential equipment has reached 19.1 percent, substantially higher than the average of 5.7 percent over the six preceeding recoveries. Conversely, growth in investment in nonresidential structures increased 7.2 percent over the current recovery compared to an average of 3.2 over the six preceeding recoveries. Total consumption, on the other hand, has experienced growth rates of only 5 percent, only slightly above the average of 4.2 percent over the six preceeding recoveries. Consequently, it appears that investment and not consumption has led the current recovery.

Table 1
Growth in Components of GNP
Over First Eight Quarter of Recovery

	Average of Six Preceeding Recoveries	Current Recovery
GNP	5.2	6.0
Consumption	4.2	5.0
Durable	6.5	12.0
Nondurable	3.4	4.2
Services	3.6	3.3
Gross Private Domestic Investment 1/	13.5	27.5
Fixed Investment	6.7	16.5
Residential	11.5	21.1
Nonresidential	5.5	15.4
Equipment	5.9	19.1
Structures	3.2	7.2
Government Puchases	4.8	1.7
State Local	3.7	1.7
Federal	5.9	1.7
Exports	9.6	6.5
Imports	12.0	16.6

1/ Gross Private Domestic Investment includes change in inventories, growth rates for inventory changes cannot be computed.

Note: Current Recovery: 82:4 to 84:4
Previous Recoveries: 49:4 to 51:4, 54:2 to 56:2, 58:1 to 60:1, 60:4 to 62:4, 69:4 to 71:4, 75:1 to 77:1, 82:4 to 84:4.

In contrast, looking at each component as a percent of GNP a different conclusion can be drawn. As a percent of GNP consumption and not investment has been the driving force of the recent expansion. Consumption has increased to 65.4 percent of GNP compared to an average of 61.4 over the six preceeding recoveries; a gain of 3.8 percentage points. The majority of this increase has been in durables and services. Gross private domestic investment also increased as a percent of GNP, but it recorded a gain of only 0.9 percentage points over the average of 15.6 percent. In this instance, as a percent of GNP, consumption not investment, has dominated the recent expansion.

There have been significant changes in the composition of gross fixed investment during the current recovery. Evidence of this is a sharp increase in nonresidential investment in equipment as a percent of GNP while residential investment and investment in nonresidential structures actually declined as a percent of GNP. The decline in investment in nonresidential structures to 3.4 percent of GNP compared to an average of 3.7 percent over the six preceeding recoveries reflects the adverse effects high real interest rates had during the current recovery. In addition, a decline in residential investment to 3.5 percent of GNP compared to an average of 4.5 percent over the six preceeding recoveries underscores the low levels of residential investment that have occurred during the last recession. In summary, short-lived assets have dominated during the current recovery while long-lived assets declined.

Table 2
Impact of the Current and Past Economic
Recoveries on Consumption and Investment

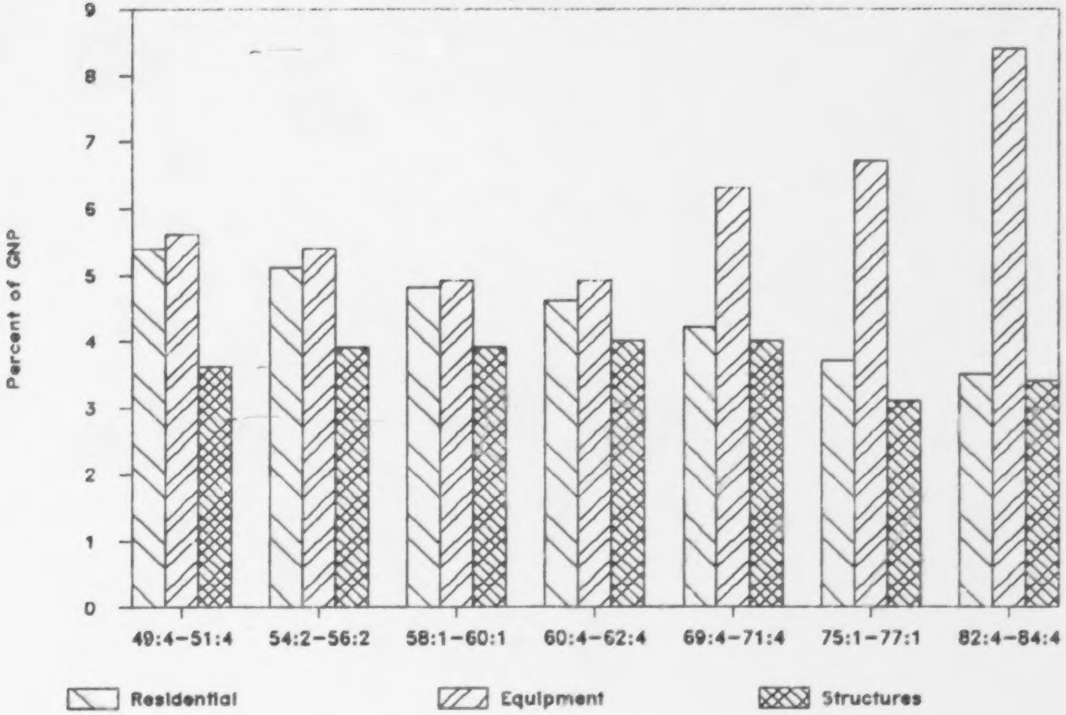
	Percent of GNP	
	Average of Six Preceeding Recoveries	Current Recovery
Real GNP	---	---
Consumption	61.6	65.4
Durables	7.7	10.4
Nondurables	25.6	24.3
Services	26.2	30.6
Gross Private Fixed Investment	13.9	15.1
Inventories Change	0.6	0.4
Residential	4.5	3.2
Nonresidential	9.4	11.9
Structures	3.7	3.5
Equipment	5.7	8.4
Imports	5.7	10.7
Exports	6.3	10.0
Government Purchases	20.8	21.2
Federal	10.3	8.7
State	10.5	12.5

Note: Current Recovery: 82:4 to 84:4
Previous Recoveries: 49:4 to 51:4, 54:2 to 56:2, 58:1 to 60:1, 60:4 to 62:4, 69:4 to 71:4, 75:1 to 77:1, 82:4 to 84:4.

Figure 1

Components of Fixed Investment

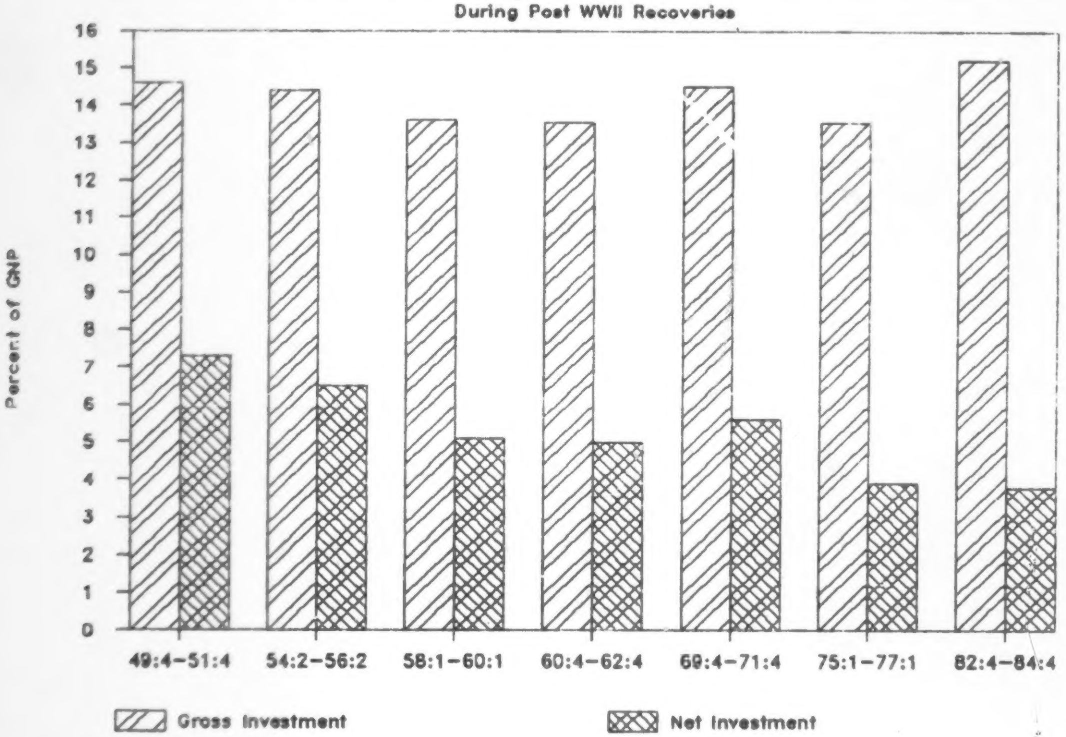
During Post WWII Recoveries



It is important to note that while the level of gross investment as a percent of GNP has increased, the level of net investment (gross investment minus depreciation) has declined as a percent of GNP (Figure 2). This is due to the shift in investment toward shorter-lived assets which depreciate more rapidily. Thus, as a greater proportion of total investment is concentrated in the shorter lived equipment, the amount of net additions to the capital stock is diminished. Of the two measures, net investment is the most important indicator for future economic growth.

Figure 2

Gross Versus Net[1] Business Fixed Investment



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[1] Net Investment equals Gross Investment minus capital consumption allowance with adjustment.

A third and more revealing method of analysis examines how much each component actually contributed to real output growth over the first eight quarters of the recovery. At first glance using this analysis (Table 3) it appears that investment as measured by Gross Private Domestic Investment has contributed more to GNP growth than consumption. However, total gross private domestic investment includes both fixed investment and changes in inventories. Of the two, changes in inventories have contributed 21.3 percent to real output growth and account for over a third of the contribution of gross private domestic investment. Thus, fixed investment, which consists of both residental and nonresidential investment, has contributed only 39.7 percent to growth in real GNP, substantially less than the 55 percent contribution by consumption. Confirming earlier analysis, nonresidential equipment investment continues to dominate fixed investment, contributing 24.8 percent to GNP growth while structures contributed just 4.2 percent to GNP growth over the recent expanison. Residential investment contributed just 10.7 percent to GNP growth during the current recovery, down from 11.8 percent during the six preceeding recoveries.

Table 3
Contribution to GNP Growth By Each Component of GNP

	Average of Six Preceeding Recoveries	Current Recovery
Consumption	55.2	55.0
Durables	12.5	20.3
Nondurables	19.8	17.3
Services	24.4	17.2
Gross Private Domestic Investment	32.8	61.0
Fixed Investment	19.3	39.7
Residential	11.8	10.4
Nonresidential	10.0	29.3
Equipment	6.1	25.1
Structures	1.3	4.2
Inventory change	13.6	21.3
Government Purchases	12.6	5.5
State & Local	9.8	3.3
Federal	18.4	2.3
Exports	5.3	5.2
Imports	-6.2	-26.7

In summary, two of the three analysis clearly indicates that consumption and not fixed investment has been the driving force of the recent expansion. In addition, any growth that has occurred in investment has resulted from increases in the shorter lived equipment with both structures and residential investment only showing modest gains due to their greater sensitivity to high real interest rates which have existed during the recent expansion and the 1981 tax law changes which resulted in a subsidy for equipment but retained a relatively high tax rate on structures.

Table 4

MARCH 1985

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:4	85:1	85:2	85:3	85:4	86:1	86:2	86:3	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,764	3,830	3,884	3,937	3,993	4,041	4,085	4,130	3,305	3,664	3,911	4,113	4,404
Percent Change	7.8	7.2	5.8	5.6	5.8	4.9	4.5	4.5	7.7	10.9	6.7	5.2	7.1
Percent Change (without inflation)	4.9	3.0	3.2	2.9	2.7	1.8	1.3	1.1	3.7	6.9	3.4	2.1	3.0
Consumption	3.6	5.6	3.8	4.1	3.3	2.8	2.8	2.4	4.8	5.3	4.1	3.0	2.8
Durables	12.7	11.9	7.5	7.2	4.7	2.9	3.0	1.9	12.1	13.0	8.1	3.8	3.3
Nondurables	0.5	4.7	3.4	3.6	3.1	2.6	2.6	2.3	3.7	4.6	2.8	2.8	2.5
Services	3.8	4.0	2.9	3.3	2.9	2.9	2.7	2.7	3.4	3.3	3.6	2.8	2.9
Residential Investment	-5.2	5.8	8.6	15.0	-1.2	-4.2	-2.1	0.5	41.7	12.2	3.2	0.6	-0.1
Nonresidential Investment	6.3	2.9	6.0	6.4	6.9	6.5	6.2	5.8	2.5	19.6	7.1	6.3	6.4
Structures	18.8	-0.4	5.7	4.4	3.4	2.4	2.5	2.2	-7.8	15.7	6.5	3.1	3.5
Equipment	1.9	4.1	6.1	7.2	3.2	8.0	7.7	7.1	7.3	21.3	7.4	7.6	7.5
Exports	2.2	5.5	3.6	3.6	4.4	4.7	6.0	7.0	-5.6	4.9	4.1	5.2	7.3
Imports	-31.9	12.8	12.1	12.7	11.8	10.3	8.6	6.7	7.6	26.5	6.2	9.9	6.0
Government Purchases	6.3	5.0	2.3	4.3	1.3	1.4	0.0	2.6	-0.3	3.5	5.2	1.6	1.4
Consumption (% of GNP)	64.6	65.0	65.1	65.3	65.4	65.5	65.8	66.0	65.8	64.8	65.2	65.8	65.7
Residential Investment (% of GNP)	3.6	3.6	3.6	3.7	3.7	3.6	3.6	3.6	3.5	3.7	3.7	3.6	3.5
Nonresidential Investment (% of GNP)	12.8	12.8	12.9	13.0	13.1	13.2	13.4	13.6	11.1	12.5	12.9	13.5	13.9
Structures (% of GNP)	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.2	3.5	3.6	3.6	3.6
Equipment (% of GNP)	9.2	9.2	9.3	9.4	9.5	9.6	9.8	9.9	7.9	9.0	9.3	9.9	10.3
Inventory Change ($ billions)	35.3	26.4	26.8	16.9	19.8	17.0	7.8	-9.8	-13.5	57.9	22.5	2.4	3.8
Mfg. Capacity Utilization Rate (%)	82	82	83	82	82	82	82	82	75	82	82	82	83
Auto.Sales (millions of units)	10.2	10.9	10.8	11.0	11.0	10.9	10.9	10.9	9.2	10.4	10.9	10.9	10.9
Domestic (% of total)	72.9	77.3	77.5	73.9	72.6	71.1	69.9	68.9	74.0	76.4	75.3	69.4	67.9
Imported (% of total)	27.1	22.7	22.5	26.1	27.4	28.9	30.1	31.1	26.0	23.6	24.7	30.6	32.1
Manufacturing Industrial Production (% change)	-0.5	5.2	4.3	2.9	3.0	1.4	2.0	2.1	7.8	11.2	3.9	2.4	4.7
Common Market	2.3	1.0	2.5	4.2	3.1	1.5	2.9	1.1	0.8	3.1	2.7	2.4	1.3
Japan	12.0	7.2	3.1	4.2	1.4	3.6	3.5	3.8	3.5	11.1	6.6	2.9	1.5
Employment(millions)(civilian:household basis)	106.0	106.6	107.1	107.7	108.1	108.4	108.7	108.8	100.8	105.0	107.4	108.7	110.7
Percent Change	2.5	2.3	2.2	1.9	1.7	1.1	0.8	0.6	1.3	4.1	2.3	1.3	1.8
Unemployment Rate (%) (civilian)	7.2	7.3	7.2	7.2	7.3	7.3	7.5	7.7	9.6	7.5	7.2	7.6	7.7
Personal Income per Household (average)<1>	39,487	40,100	40,463	40,926	41,399	41,926	42,404	42,831	35,415	38,535	40,722	42,615	45,204
Percent Change -- Year Ago (w/o inflation)	4.9	3.8	2.7	2.4	2.0	1.7	1.6	1.2	1.5	5.4	2.7	1.4	2.0
Personal Taxes per Household (average)	7,158	7,345	7,423	7,519	7,621	7,737	7,838	7,933	6,478	6,955	7,477	7,890	8,392
Percent Change -- Year Ago (w/o inflation)	5.6	5.3	4.2	3.9	3.3	2.5	2.6	2.3	-3.0	3.4	4.2	2.4	2.3
Percent of Personal Income	18.9	19.2	19.2	19.2	19.2	19.3	19.3	19.4	19.1	18.8	19.2	19.4	19.4
Disposable Income per Household (average)	32,328	32,755	33,040	33,407	33,778	34,190	34,566	34,898	28,938	31,581	33,245	34,726	36,812
Percent Change--Year Ago (w/o inflation)	4.7	3.5	2.5	2.2	1.9	1.6	1.5	1.1	2.5	5.8	2.5	1.2	1.9
Household Interest Payments (% of total)	10.4	10.3	10.4	10.7	10.8	10.7	10.7	10.8	9.8	10.4	10.6	10.7	9.9
Net Worth Per Household (average)	79,983	81,895	83,729	85,448	86,767	88,752	90,116	91,549	73,840	77,668	84,460	90,722	96,889
Percent Change--Year Ago (w/o inflation)	2.7	4.7	6.0	5.5	5.3	5.4	4.6	3.9	7.6	1.4	5.4	4.2	2.7
Consumer Price Inflation (CPI)	3.9	2.9	3.3	3.2	3.3	3.6	3.7	3.8	3.2	4.2	3.4	3.6	4.3
Gross National Product Inflation (GNP Deflator)	2.8	4.1	2.5	2.7	2.9	3.0	3.1	3.4	3.8	3.8	3.2	3.0	3.9
Personal Consumption Inflation	2.6	2.3	2.4	2.6	2.9	3.3	3.5	3.6	3.7	3.2	2.7	3.2	4.0
Residential Construction Inflation	-0.3	1.6	2.3	2.5	3.0	3.7	4.1	4.1	1.7	3.8	2.5	3.5	4.6
Nonresidential Construction Inflation	0.5	0.6	1.5	2.2	3.0	3.9	4.2	4.2	-1.0	0.3	1.3	3.5	4.7
Producers Price Inflation (WPI)	0.5	-0.3	0.8	1.1	2.0	2.2	2.4	2.9	1.3	2.4	0.5	2.1	3.5
Compensation per Manhour (% change)	3.3	5.5	3.5	3.7	4.3	5.3	4.4	4.5	4.8	4.2	4.1	4.5	5.3
Productivity (% change)	1.5	1.6	1.6	2.0	1.8	1.4	1.2	1.5	3.4	2.7	1.5	1.6	1.8
Unit Labor Cost (% change)	1.8	3.7	1.8	1.6	2.4	3.9	3.1	2.9	1.3	1.5	2.5	2.9	3.5
Unit Capital Cost (% change)	4.3	4.1	3.9	3.5	3.1	2.8	2.5	2.3	6.9	4.6	3.7	2.4	1.8
Before Tax Corporate Profits ($ billions)<2>	243	240	245	243	245	242	238	232	213	245	243	237	258
Corporate Tax Liability	95	93	94	93	94	94	93	89	86	98	93	92	103
After Tax Profits	148	147	151	150	151	147	146	143	127	148	150	145	155
Inventory Valuation Adjustment	-3	0	-3	-6	-9	-11	-12	-14	-11	-6	-5	-13	-20
Capital Consumption Adjustment	64	70	75	81	87	89	92	93	33	56	78	93	90
Profits from Current Production (with IVA, CCA)	209	217	224	225	228	225	226	222	149	197	224	224	226
Adjusted for Inflation (84:3 base)	208	214	219	218	220	215	214	209	156	198	218	212	205
Percent Change - Year Ago	14.9	13.6	11.1	9.3	5.9	0.9	-2.2	-4.1	46.0	27.3	9.9	-2.6	-3.2
Per Unit of Output (% of GNP)	5.6	5.7	5.8	5.7	5.7	5.6	5.5	5.4	4.5	5.4	5.7	5.5	5.1
Effective Corporate Tax Rate (%)<2>	30	29	29	28	28	29	28	28	34	32	28	28	31
Federal Tax Receipts (Unified basis)	665	659	844	754	696	685	928	764	613	683	738	776	835
Percent of GNP	17.7	17.2	21.7	19.1	17.4	16.9	22.7	18.5	18.6	18.6	18.9	18.9	19.0
Federal Expenditures (Unified basis)	954	940	947	934	967	985	992	997	803	868	947	997	1,065
Percent of GNP	25.4	24.5	24.4	23.7	24.2	24.4	24.3	24.1	24.3	23.7	24.2	24.2	24.2
Surplus or Deficit (Unified basis)	-290	-281	-103	-180	-271	-300	-64	-233	-190	-184	-209	-221	-230
% of GNP	7.7	7.3	2.6	4.6	6.8	7.4	1.6	5.7	5.8	5.0	5.3	5.4	5.2
% of Personal Savings	174.7	178.6	69.4	126.2	194.3	213.9	46.3	177.4	158.1	116.5	142.1	165.4	154.6
% of Net Domestic Savings	83.5	81.3	29.9	53.7	81.2	92.2	19.8	75.8	80.0	56.1	61.5	70.4	69.7

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 5

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:4	85:1	85:2	85:3	85:4	86:1	86:2	86:3	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	3,817	4,151	4,347	4,446	4,307	4,239	4,129	4,019	3,751	3,933	4,313	4,075	3,838
Percent Change -- Year Ago	0.7	0.4	7.1	19.5	12.8	2.1	-5.0	-9.6	42.4	4.9	9.6	-5.5	-5.8
Existing Single-Family Home Sales (thousands)	2,813	3,099	3,199	3,299	3,198	3,150	3,050	2,950	2,716	2,866	3,199	3,000	2,783
Percent Change - Year Ago	1.0	6.3	7.6	19.4	13.7	1.7	-4.7	-10.6	36.5	5.5	11.6	-6.2	-7.2
Dollar Volume (billions)	242.2	268.6	281.9	291.3	276.0	277.3	274.7	267.8	224.2	247.1	279.5	268.2	257.3
Existing Home Prices - Median ($1000's)	72.0	73.6	75.4	76.0	74.6	76.4	78.4	79.2	69.8	72.3	74.9	77.9	81.0
Percent Change - Year Ago	2.8	3.2	3.7	3.8	3.7	3.8	4.0	4.2	3.2	3.5	3.6	4.0	4.0
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	656	638	639	649	646	662	689	701	633	665	643	686	722
Percent of Household Income	21	20	20	20	20	20	20	21	22	22	20	20	20
Private Housing Starts (thousands)	1,586	1,738	1,843	1,835	1,791	1,790	1,784	1,777	1,704	1,764	1,802	1,780	1,746
Percent Change - Year Ago	-6.6	-10.7	-0.8	10.3	12.9	3.0	-3.2	-3.2	61.3	3.5	2.2	-1.2	-1.9
Single-Family	1,035	1,085	1,183	1,183	1,143	1,122	1,112	1,102	1,066	1,100	1,149	1,108	1,088
Percent of Total	65.3	62.4	64.2	64.5	63.8	62.7	62.3	62.0	62.6	62.4	63.7	62.3	62.3
Multi-Family	551	654	660	652	648	668	672	675	637	663	653	672	658
Percent of Total	34.7	37.6	35.8	35.5	36.2	37.3	37.7	38.0	37.4	37.6	36.3	37.7	37.7
Mobile Home Shipments	291	303	314	320	324	328	335	333	296	294	315	332	329
New Single-Family Home Sales (thousands)	617	629	660	689	678	660	650	640	626	639	664	645	635
Percent Change - Year Ago	-8.1	-9.1	4.3	12.3	9.9	5.0	-1.6	-7.2	50.1	2.0	3.9	-2.9	-1.5
New Home Prices - Median ($1000's)	79.5	80.0	80.7	81.5	82.3	83.2	84.3	85.4	75.5	79.8	81.1	84.9	89.6
Percent Change - Year Ago	4.8	2.7	0.3	0.1	3.5	4.0	4.4	4.8	8.9	5.8	1.6	4.6	5.6
New Home Prices--Mean ($1000's, Quality Adjusted)	95.0	94.8	95.3	96.5	97.2	97.5	98.4	100.1	89.7	93.6	96.0	99.3	103.8
Percent Change - Year Ago	5.3	4.2	2.0	1.5	2.3	2.9	3.3	3.7	2.1	4.4	2.5	3.5	4.6
NAR Affordability Index	86.2	88.0	87.9	90.5	89.9	90.3	87.0	88.0	82.0	86.2	89.1	88.5	89.0
New Mortgage Commitments ($ billions)	181.6	182.7	188.4	194.4	199.3	209.2	206.8	204.5	163.4	189.5	191.2	204.4	199.0
Percent Change - Year Ago	10.7	-4.4	-8.8	8.7	[illegible]	14.5	9.8	5.2	152.1	16.0	0.9	6.9	-2.6
Mortgage Debt Outstanding ($ billions)	2,033	2,127	2,223	2,312	2,403	2,330	2,287	2,262	1,752	1,953	2,266	2,283	2,273
Homeowners' Equity ($ billions)<1>	1,479	1,492	1,505	1,522	1,540	1,561	1,584	1,610	1,554	1,504	1,515	1,598	1,702
Housing Inventory (millions)	91.7	92.0	92.4	92.8	93.1	93.5	93.9	94.3	89.6	91.1	92.6	94.1	95.6
Rental Vacancy Rate (%)	6.3	6.2	6.1	5.9	5.8	5.8	5.8	5.8	5.6	5.9	6.0	5.8	5.8
Unsold New Homes (% of sales)	55.7	54.1	56.4	60.1	64.1	63.7	63.6	60.6	43.0	50.6	58.7	61.7	53.8
Office Vacancy Rate (%)<2>	14.7	10.7	10.4	10.1	[illegible]	9.7	9.5	9.4	11.7	13.9	10.3	9.5	9.1
Industrial Vacancy Rate (%)<2>	4.7	4.0	3.9	3.8	[illegible]	3.7	3.7	3.6	4.9	4.7	3.9	3.6	3.4
New Commercial Building Construction (% Ch Value)	56.0	-0.8	3.5	3.3	[illegible]	-0.6	-6.1	-5.5	-4.2	37.4	13.8	-1.5	0.8
New Industrial Building Construction (% Ch Value)	27.4	8.5	25.3	17.6	28.2	21.6	16.1	11.9	-25.7	11.9	17.3	20.1	18.3
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	3.4	9.0	5.5	5.2	4.6	5.4	5.1	5.7	11.2	6.9	5.8	5.2	5.3
M1 Velocity (% change)	4.2	-1.7	0.2	0.4	1.1	-0.5	-0.6	-1.1	-3.2	3.7	0.9	0.0	1.6
M2 (% change)(FED Target 6-9%)	9.3	14.3	6.1	5.1	5.4	5.7	7.6	7.6	12.6	7.7	8.7	6.2	6.5
M2 Velocity (% change)	-1.4	-6.2	-0.3	0.5	0.4	-0.8	-2.9	-2.9	-4.4	3.0	-1.8	-1.0	0.5
Monetary Base (% change)	4.5	10.8	3.8	4.8	5.0	5.3	5.1	4.8	9.5	8.1	6.5	5.0	5.7
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	655	652	662	663	676	687	696	690	479	654	663	694	753
Private													
Personal Savings	166	157	148	142	140	141	137	132	118	157	147	134	148
Savings Rate	6.3	5.9	5.4	5.2	5.0	5.0	4.8	4.5	5.0	6.1	5.4	4.7	4.8
Gross Business Savings	540	552	562	567	574	576	582	585	454	520	564	584	615
Government													
Federal	-195	-196	-198	-203	-206	-203	-208	-214	-179	-175	-201	-209	-218
State and Local	55	56	59	57	58	55	56	53	44	53	57	55	62
Foreign (current account deficit)	90	83	90	99	110	119	128	134	42	100	96	130	145
Uses (total:gross investment)	634	632	644	650	663	671	673	668	472	637	647	675	735
Nonresidential Investment													
Equipment	288	291	296	302	310	317	326	334	223	275	300	330	367
Structures	158	158	161	164	166	169	172	175	130	150	162	173	188
Residential Investment	153	156	160	167	168	167	168	170	132	154	163	169	177
Inventory Investment	35	26	27	17	20	17	8	-10	-13	58	22	2	4
Value of the U.S. Dollar (Weighted by Trade) (Base=1967)	1.145	1.189	1.200	1.173	1.145	1.120	1.100	1.081	1.024	1.095	1.177	1.092	1.032
Percent Change	8.9	17.1	3.7	-8.8	-9.2	-8.4	-7.1	-6.4	3.7	6.9	7.5	-7.2	-5.5
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	14.0	13.3	12.9	12.9	13.2	13.2	13.4	13.5	13.9	14.2	13.1	13.4	13.7
Real Mortgage Rate (30 yr. avg. is 4.5%)	11.3	9.2	10.5	10.4	10.4	10.3	10.4	10.2	10.2	10.5	10.1	10.2	9.5
1 Year ARM (without buy-down)	11.7	10.7	11.0	11.1	11.1	11.3	11.4	11.5	11.3	12.6	11.0	11.4	12.2
Real Mortgage Rate	9.0	6.6	8.5	8.4	8.2	8.3	8.3	8.1	7.5	9.0	7.9	8.1	8.0
Corporate Bond Rate (AAA)	12.3	11.9	11.1	11.1	10.8	10.9	10.7	11.0	12.0	12.7	11.2	10.9	11.2
Government Bond Rate	11.8	11.5	11.1	11.0	10.7	10.7	10.5	10.5	11.3	12.5	11.1	10.5	10.8
Real Government Bond Rate (30 yr. avg. is 2.1%)	9.0	7.4	8.6	8.3	7.7	7.7	7.3	7.1	7.6	8.9	8.0	7.1	6.6
Federal Funds Rate	9.3	8.2	8.5	8.8	9.2	9.5	9.7	9.8	9.1	10.2	8.7	9.8	10.9
3 Month Treasury Bill Rate	8.8	7.9	8.2	8.3	8.5	8.7	8.8	8.9	8.6	9.5	8.2	8.9	9.6
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	6.1	3.8	5.7	5.7	5.5	5.7	5.7	5.5	4.8	5.9	5.2	5.5	5.5
1 Year Treasury Bill Rate	10.0	9.0	9.3	9.4	9.4	9.6	9.7	9.8	9.6	10.9	9.3	9.7	10.5
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	7.3	4.9	6.8	6.7	6.5	6.6	6.6	6.4	5.8	7.3	6.2	6.4	6.3
Commercial Paper Rate	9.2	8.1	8.5	8.8	9.1	9.3	9.5	9.7	8.9	10.1	8.6	9.6	10.8
Rate on Money Market Fund Shares	9.3	8.3	8.7	8.9	9.2	9.5	9.6	9.8	9.0	10.3	8.8	9.7	10.8
Prime Rate	11.8	10.5	10.5	10.6	10.9	11.3	11.4	11.7	10.8	12.0	10.6	11.5	12.5

<1> Homeowners Equity has been adjusted to correspond to the Federal Reserve's Flow of Funds data.
<2> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

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Outlook for the Economy and Real Estate

Aggregate Economy

As the recovery enters its 29th month, there is abundant evidence that it is losing its momentum and the economy has entered a period of below-average growth that should last about 12 to 15 months. In its "flash" estimate, the Commerce Department predicts that real or inflation-adjusted Gross National Product (GNP) increased at an annual rate of just 2.1 percent during the first three months of this year. This is a substantial drop from the 4.3 percent growth rate of the final quarter of 1984 and is due primarily to a surge in imports over the period. However, based on recent employment data it appears that economic activity picked up in March, suggesting that the first quarter growth rate will be revised upward to about 2.5 percent.

Consumption, which represents two-thirds of GNP, continues to be the driving force of the current expansion with particularly strong spending on consumer durables. Consumption expenditures are expected to have increased 5.8 percent during the first quarter compared to 3.6 percent during the previous quarter. Domestic automobile sales remain strong with mid-March sales at a seasonally-adjusted annual rate of 8.5 million units. However, this pace of consumer spending cannot be sustained as it exceeds growth in personal income. Consumers have reduced savings and added to existing debt to finance their purchases, suggesting a significant slow down in this type of spending over the remainder of 1985 and through 1986.

After weakening during the last half of 1984, residential investment is currently providing a substantial boost to GNP growth and should continue to do so for the next six months as homebuyers and builders respond to improved affordability. Total housing starts should reach a 1.8 million unit annual pace during the second and third quarter, then start dropping off modestly as long-term interest rates start edging up.

Business investment spending continues to soften, particularly inventory investment and construction of new commercial and industrial structures. After increasing nearly 16 percent in 1984, investment in new commercial and industrial structures should increase just 7 percent in 1985 as construction of new office space declines in response to high vacancy rates and construction of new retail space peaks. The pace of investment in new equipment is also slowing as businesses have scaled back their projected capacity requirements in response to the slowing economy. Moreover, the impact of this equipment investment on domestic output is declining as a growing share of this spending goes for imports.

The growing trade imbalance is putting a severe drag on economic growth. Despite some growth in exports, the overall level remains depressed as most of our trading partners continue to follow contractionary fiscal policies. At the same time the strong dollar and healthy levels of domestic spending encourage rapid growth of imports, resulting in a widening merchandise trade deficit. Frustration with our serious trade imbalance has led to some irresponsible "Japan bashing" and calls for retaliatory protectionit measures in the U.S. Senate. While it is certainly the case that Japanese markets are not as open to imports as are U.S. markets, the primary cause of the nearly $40 billion U.S. trade deficit with Japan is the overvaluation of the U.S. dollar which is the result of the huge federal deficit.

Overall, real GNP should increase about 3 percent during the second quarter followed by declining growth rates thereafter. This expected increase in the growth rate is due primarily to the fact that there probably will not be a major increae in imports as occurred during the first quarter. By the end of 1985 real growth should be at about 2 percent, dropping below that level in 1986. The performance of the economy should then improve in 1987 as business investment picks up and the trade balance improves.

Employment and Inflation

Employment increased an estimated 2.6 percent during the first quarter, comparable to growth during the last quarter of 1984. Most of this growth in employment was in the service sector while manufacturing provided a relatively small share of employment growth. In March the civilian unemployment rate held steady at 7.3 percent as increases in the labor force matched increases in employment. As the economy slows over the remainder of 1985 and through 1986 the unemployment rate is expected to edge up into the 7 1/2 to 8 percent range as growth in the labor force outpaces increases in employment.

The inflation outlook remains optimistic as the Consumer Price Index (CPI) continues to increase at annual rates under 4 percent. In February the CPI increased 0.3 percent, resulting in a 3.5 percent increase over the last 12 months. The Producer Price Index for finished goods declined 0.1 percent resulting in an increase of just 0.7 percent in this index over the past 12 months. The index for crude goods fell 1.9 percent in February after falling 2.2 percent in January. Over the 12 month period ending in February this index fell 4.3 percent with most of this decrease occuring in nonfood materials used in manufacturing, including crude oil and metals. The softness in producer prices and continued modest increases in wage costs are expected to hold inflation under 4 percent through 1986. However, a sharper than expected decline in the dollar would likely result in more rapid inflation due to increased prices for imports and less competition for domestic producers.

Monetary Policy and Interest Rates

Both short-and long-term interest rates rose about 100 basis points (one percentage point) from late January through mid-March. This increase in rates appears to have been prompted by investor concern over reports of real GNP growth of 4 percent or more during the first quarter and fears of a tightening move by the Federal Open Market Committee (FOMC) of the Federal Reserve Board (FED) at its meeting on February 12-13. Since mid-to-late March short-term rates have fallen about 50 basis points and long-term rates about 25 basis points as it has become apparent that the economy is weaker than was generally believed and because of a lack of any evidence of a credit tightening policy change by the FED. Recently released minutes of the February FOMC meeting confirm that no tightening action was taken in light of continued low inflation and concerns about the strength of the dollar.

The available evidence suggests that short-term interest rates should soon start to rise again and should climb about 50 basis points by the end of the year due to increasing loan demand associated with moderate economic growth. Contributing to this relatively modest increase in short-term interest rates is the expectation that the FED will not tighten its credit stance due to continued low inflation, a strong dollar, and weakness in several sectors of the economy such as agriculture and manufacturing. Long-term rates should continue to fall about another 25 basis points over the next several weeks and then remain fairly stable through the rest of the year as the supply of long-term funds keeps pace with demand and expectations of future inflation continue to slowly edge downward. Keep in mind that despite this expected stability of interest rates, real or inflation-adjusted interest rates remain two to four times higher than their average over the 30-year period from 1950 to 1980 due to the large and expanding federal deficit and the fact that because of this deficit monetary policy is tighter than it otherwise would need to be.

Since Chairman Volcker's appearances before Congress earlier this year, there has been some confusion in the financial press over the correct method of computing the upper and lower targets for the monetary aggregates (i.e., M1, M2, etc.). Traditionally, the FED has used the fourth quarter average actual level of the monetary aggregates, centered in November, as the base for computing the upper and lower target ranges for the following year. This procedure results in the familiar cone shape where the target range is very narrow in the beginning of the year and gets progressively larger as the year proceeds.

In his testimony, Chairman Volcker noted that M1, M2, and M3 were above their target ranges as expressed by the cone approach for the month of January but that he and other members of the FED were not overly concerned, implying that the FED saw no immediate need to take corrective actions. The stated reason for this lack of concern was that in the early part of the year the target range is very narrow, leaving little leeway for variations in growth rates. Volcker referred to an alternative method of computing the target ranges called the "tunnel" or "parallel band" approach. Using the same base as the cone approach, a growth line based on the mid-point of the target range (5 1/2 percent for the 4 to 7 percent target range for M1) is computed through the end of the year. Then two parallel lines are drawn above and below the mid-point growth line representing the upper and lower target ranges. The target range at the end of the year is the same under both approaches, but under the parallel band approach the target range is equally spaced throughout the year. As shown in Diagram 1, through March of this year, M1 has been within its target range when expressed in this parallel band approach.

Another reason the FED has not tightened credit conditions in spite of very rapid money growth so far this year is that the base for the 1985 targets, the average actual level for the fourth quarter of 1984, was below the mid-point of the 1984 target level. Diagram 2 presents the 1985 target range for M1 based on the mid-point of the target for the fourth quarter of 1984. In this case M1 is well within the parallel band target range for 1985.

Diagram 1

1985 MONEY STOCK (M1) AND TARGETS

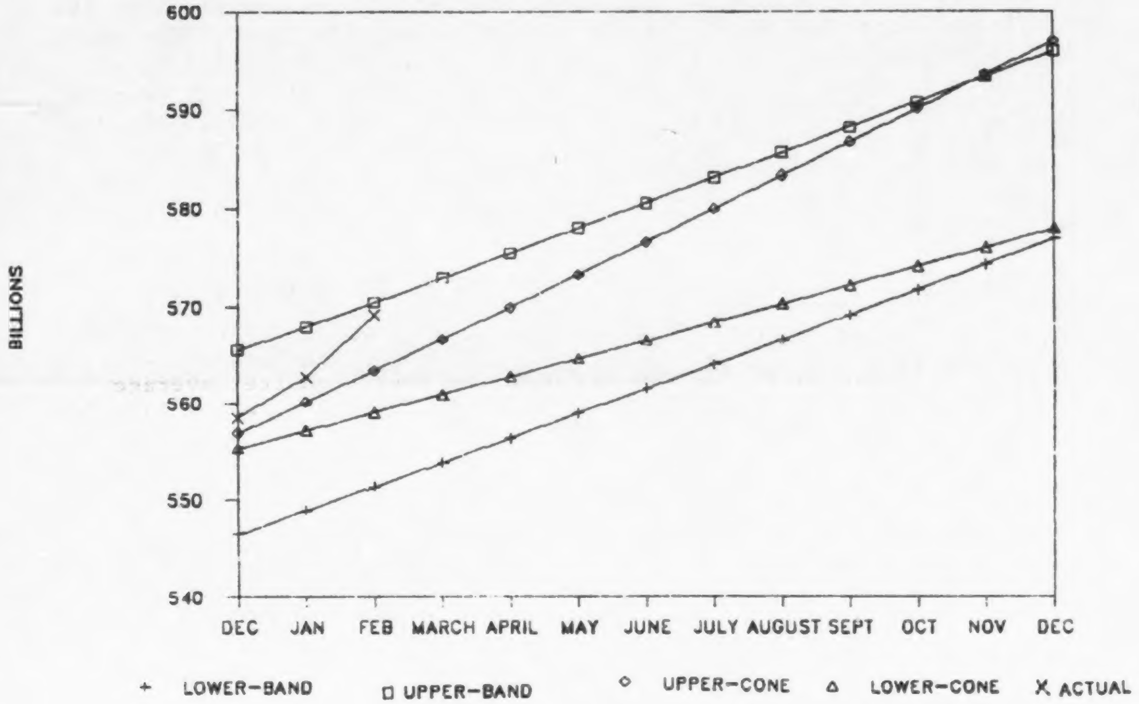
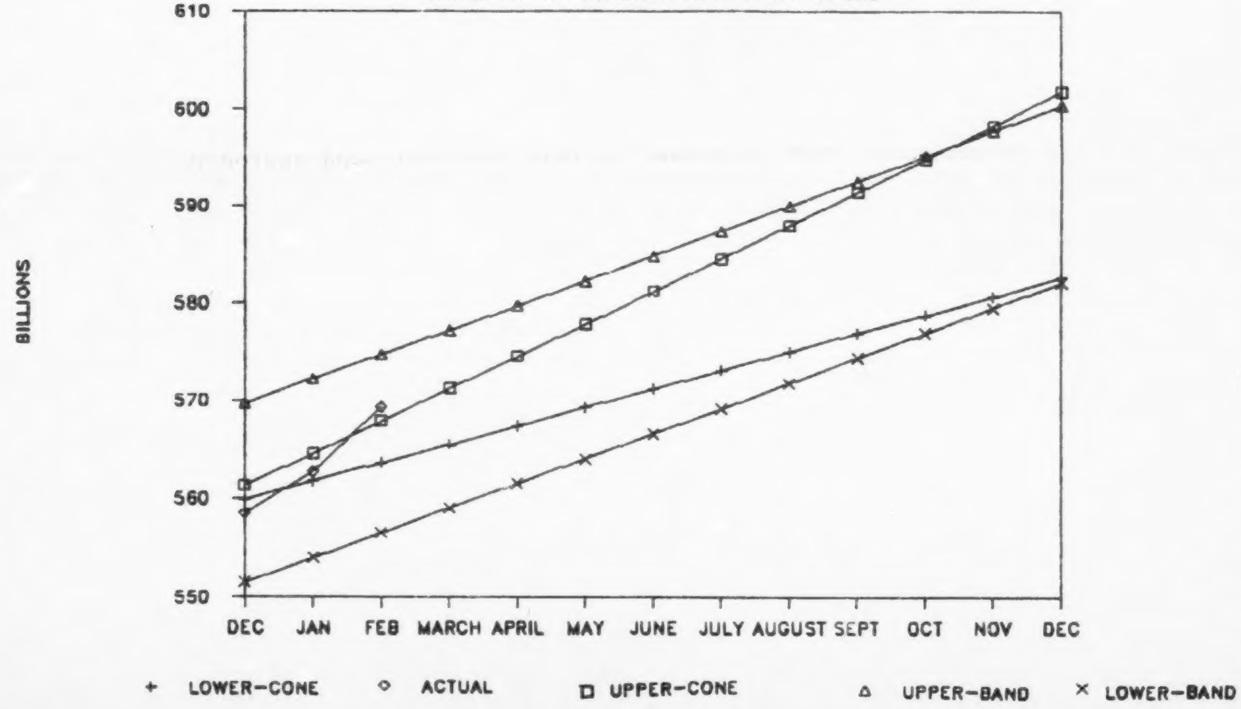


Diagram 2

1985 MONEY STOCK (M1) AND TARGETS

BASED ON 4TH QUARTER TARGET NOT ACTUAL



Fiscal Policy

With the White House and the Senate Republican leadership compromise on the federal budget there is hope that an end to the deficit stalemate is in sight. In fact, the mere announcement of the compromise resulted in a significant rally in the bond markets. The significance of this compromise is that it goes beyond the one-year "freeze" of federal spending, which would provide minimal deficit reduction, and recommends serious structural changes in federal spending. These changes include 3 percent real growth of defense spending and less than full CPI cost-of-living adjustments for entitlement programs, including social security. The result of these changes would be gradual reductions in federal spending as a percent of GNP, putting the federal budget on the path toward balance. Realistically, total elimination of the deficit would take eight to ten years under this approach. However, if enacted into law, it would provide immediate economic benefit which would grow more significant over time. As shown in Table 1, if enacted as the FY 1986 budget, by 1988 mortgage interest rates would likely be reduced by one full percentage point resulting in 150,000 additional housing starts, 300,000 additional existing home sales, 500,000 additional full-time jobs, and an additional $350 in income for every household in the country. In ten years, mortgage interest rates would be about 2 1/4 percentage points lower, with significant increases in overall economic activity. Further, without the burden of financing today's huge deficits, a greater proportion of overall economic activity will go towards all forms of investment, further enhancing the nation's growth potential.

Table 1

Impacts of Deficit Reduction on the U.S. Economy

	1988	1990	1995
GNP (1985 Dollars in Billions)	30	68	130
Percent	0.7	1.5	2.5
Mortgage Interest Rates (percentage points)	-1.0	-1.4	-2.2
Employment (millions of jobs)	0.5	0.6	1.1
Percent	0.4	0.5	0.9
Income per Household (1985 Dollars)	350	790	1450
Residential Investment (1985 Dollars in Billions)	11.5	20.8	28.8
Percent	6.8	13.5	18.6
Housing Starts (000's)	150	220	275
Percent	8.2	15.5	22.2
Existing Home Sales (000's)	300	450	600
Percent	10.0	15.0	20.0
Nonresidential Investment (1985 Dollars in Billions)	25.1	60.4	108.9
Percent	4.6	10.4	15.2
Percent of GNP (percentage points)	0.5	1.1	2.0
Equipment (1985 Dollars in Billions)	15.2	37.4	67.6
Percent	4.2	9.9	14.7
Structures (1985 Dollars in Billions)	10.0	23.0	41.3
Percent	5.5	11.6	15.9
Productivity (percent)	0.5	0.9	1.6
Trade-Weighted Value of the Dollar (percent)	-9.6	-10.2	-12.0
Net Exports (1985 Dollars in Billions)	30	43	77
Percent	19.6	29.3	44.5
Inflation (percentage points)	0.3	0.2	-0.6

SOURCE: Testimony before the Senate Committee on the Budget on the First Concurrent Budget Resolution for FY 1986, February 22, 1985.

Real Estate Markets

Lower and more stable mortgage interest rates are resulting in impressive gains in resales of existing single-family homes and starts and sales of new homes. Over the first three months of this year resales are expected ot have risen about 6 1/2 percent over the previous quarter to a seasonally-adjusted annual rate of 3 million units. Total housing starts are expected to have reached a seasonally-adjusted annual rate of 1.73 million units, 8 percent above the final quarter of 1984.

This increase in resales and starts is the result of strong improvement in affordability.. In February the NATIONAL ASSOCIATION OF REALTORS® Affordability Index reached 88.7, its highest level since December 1979. This means that a family earning the median income had 88.7 percent of the income needed to qualify to purchase the median-priced existing single-family home.

With stable mortgage rates and family incomes increasing faster than home prices, affordability should continue to improve. The Affordability Index should hit the 90 level during the next several quarters and then plateau at that level as family income growth slows.

With further improvement in affordability, resales are expected to reach the 3.2 million annual rate during the third quarter and average 3.1 million units for the entire year. Similarly, housing starts should increase to an annual rate of 1.83 million units by the second quarter and average 1.79 million units for the year. In 1986 housing market activity should retreat somewhat due to higher mortgage interest rates and a slower economy. Resales should decline about 4 percent to 2.98 million units while starts decline a little over 2 percent to 1.75 million units.

New investment in both commercial and industrial real estate continued at healthy levels during the first quarter of 1985 but should follow vastly different trends over the remainder of 1985 and through 1986. With the office vacancy rate in excess of 10 percent nationwide, it appears that the office building boom is coming to a skretching halt. While the value of new commercial construction put in place increased at a seasonally adjusted annual rate of about 34 percent during the first quarter, only modest increases are expected for the remainder of 1985 and through 1987. In contrast, the industrial vacancy rate is at about 4 percent now and is expected to further decline over the next few years, prompting increasing levels of investment in this type of property.

Special Supplement

Tax Reform Productivity of Tax Provisions Affecting Commercial Real Estate

With the introduction of the Treasury Tax Reform Proposal and the continuing threat of some form of tax increase this year to reduce the deficit, analysts in both the government and the private sector have been conducting in-depth research into the impact of various provisions of the tax code on the performance of the economy. The underlying principal of tax reform is to reduce marginal personal and corporate tax rates in return for expanding the base of taxable income. The Treasury proposal calls for expanding the tax base through such actions as slowing the rate at which assets are depreciated, repealing the investment tax credit for equipment and the various rehabilitation tax credits for older structures, reducing the deductability of interest expense for both individuals and businesses, repealing the tax exempt status of mortgage revenue bonds, extending "at risk" rules to real estate, and various other changes. Similarly, both the 1982 and 1984 tax bills (TEFRA and TRA, respectively) resulted in increased tax revenues by expanding the tax base as opposed to increasing tax rates. TEFRA repealed the phase in the 200 percent declining balance method of depreciation for equipment as called for by ERTA and enacted a partial basis adjustment for the investment tax credit. TRA lengthened the depreciation period for structures from 15 to 18 years.

The issue that is being researched is the magnitude of the change in economic activity per dollar of tax revenue either gained or lost through various changes in the tax code. For example, how much of a reduction in GNP results from a dollar of tax revenue gained through reducing depreciation deductions as opposed to a dollar of tax revenue gained through repeal of the investment tax credit. If there are significant differences in the impacts of the various potential changes in the tax code, then policy makers seeking to raise a specific amount of tax revenue would know how to minimize the negative impacts on the economy. This type of analysis is rumored to be used by the new leadership in the Treasury Department.

Table 2 presents the results of some of this research which analyzes the impact of various elements of the old Treasury tax reform proposal on a typical commercial real estate investment. These various elements are ranked by both productivity and diffusion. Productivity in this case is defined as dollars of investment in commercial real estate lost per dollar of tax revenue gained. For example, lengthening depreciation schedules for structures as proposed in the initial Treasury proposal would result in roughly $5.30 of this type of investment lost for every $1 of tax revenue gained. Morever, this depreciation proposal is very diffuse since it would effect all depreciable real estate. In contrast, repealing the tax exempt status of mortgage revenue bonds would result in roughly $2.10 of this type of investment lost for every $1 of tax revenue gained. In addition, this provision would impact fewer properties, thus leading to a lower diffusion value.

In addition to productivity and diffusion, the Treasury Department is considering "fairness" which is much more subjectived to calculate and is emerging from the political debate in the Administration and Congress.

Table 2

The Treasury Department's Initial Proposals for Tax Reform Ranked by Productivity and Diffusion Based on Analysis of Typical Commercial Property

		PRODUCTIVITY	DIFFUSION
•	Replace current 18-year depreciation system with a system which indexes assets basis for inflation and allows a 3% per year deduction.	5.3	4
•	Repeal all tax credits for rehabilitation expenses.	3.0	1
•	Repeal current capital gains exclusion and instead index asset basis for inflation and tax only "real" gain at reduced marginal tax rates.	2.7	4
•	Reduce deductibility of interest expense of trade or business by inflation adjustment.	2.6	4
•	Extend "at risk" rules to real estate which allows loss deductions only up to an amount equal to recourse indebtedness and cash.	2.6	3
•	Tax partnerships with more than 35 members as corporations.	2.6	2
•	Repeal the tax exemption for mortgage revenue bonds and industrial development bonds.	2.1	2
•	Limit all non-principal residence interest deductibility to $5,000 plus investment interest and reduce deductible amount by inflation adjustment.	1.2	3

1/ The higher the productivity number, the greater the reduction in real estate investment per dollar of tax revenue gained include formula.

2/ The higher the diffusion number, the higher the proposed percentage of the real estate industry affected by this.

Table 3

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:4	85:1	85:2	85:3	85:4	86:1	86:2	86:3	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,759	3,829	3,877	3,929	3,981	4,029	4,075	4,120	3,305	3,663	3,904	4,101	4,402
Percent Change	7.1	7.7	5.1	5.5	5.4	5.0	4.6	4.5	7.7	10.8	6.6	5.0	7.4
Percent Change (without inflation)	4.3	2.5	3.0	2.4	2.2	1.8	1.5	1.0	3.7	6.8	3.0	1.9	3.2
Consumption	3.6	5.8	2.8	3.5	2.8	3.5	2.5	3.0	4.8	5.3	3.8	3.0	2.8
Durables	14.1	10.1	3.3	5.2	3.4	4.5	2.4	3.7	12.1	13.1	6.8	3.6	4.0
Nondurables	-0.5	5.9	2.9	3.4	2.6	3.2	2.3	2.5	3.7	4.6	3.0	2.7	2.4
Services	3.3	4.1	2.5	2.9	2.7	3.4	2.6	3.2	3.4	3.2	3.4	2.9	2.8
Residential Investment	-5.9	4.8	7.3	10.9	0.1	-2.1	-1.4	-1.9	41.7	12.2	2.2	0.8	0.4
Nonresidential Investment	8.5	3.3	3.0	5.1	3.7	4.3	4.6	4.1	2.5	19.8	7.3	4.7	6.1
Structures	17.2	8.3	-2.7	3.2	2.2	1.4	2.7	1.9	-7.8	15.6	6.6	2.0	8.9
Equipment	5.4	4.2	5.2	5.8	7.0	5.4	5.3	4.9	7.3	21.5	7.6	3.7	6.9
Exports	-0.8	10.0	3.7	4.2	5.3	5.4	7.0	7.6	-5.6	4.7	4.7	5.9	7.3
Imports	-28.3	32.6	7.1	7.6	8.3	7.4	6.5	5.2	7.6	27.0	9.9	7.0	5.2
Government Purchases	5.9	0.8	1.8	5.5	-0.2	-0.1	-1.1	12.0	-0.3	3.5	4.0	1.8	2.2
Consumption (% of GNP)	64.7	65.2	65.2	65.3	65.4	65.7	65.9	66.2	65.8	64.8	65.3	66.0	65.7
Residential Investment (% of GNP)	3.6	3.6	3.6	3.7	3.7	3.6	3.6	3.6	3.5	3.7	3.6	3.6	3.5
Nonresidential Investment (% of GNP)	12.9	12.9	12.9	13.0	13.1	13.2	13.3	13.4	11.1	12.5	13.0	13.4	13.7
Structures (% of GNP)	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.6	3.2	3.5	3.6	3.6	3.6
Equipment (% of GNP)	9.3	9.3	9.4	9.5	9.6	9.6	9.7	9.8	7.9	9.0	9.4	9.8	10.1
Inventory Change ($ billions)	36.6	38.5	44.1	29.7	30.7	24.6	20.7	-18.7	-13.5	58.2	35.7	2.8	2.9
Mfg. Capacity Utilization Rate (%)	82	81	81	81	81	81	81	81	75	82	81	81	82
Auto Sales (millions of units)	10.2	11.0	10.7	10.8	10.8	10.8	10.7	10.8	9.2	10.4	10.8	10.7	10.9
Domestic (% of total)	72.9	78.3	77.3	73.3	72.0	70.7	69.5	68.7	74.0	76.4	75.2	69.2	67.9
Imported (% of total)	27.1	21.7	22.7	26.7	28.0	29.3	30.5	31.3	26.0	23.6	24.8	30.8	32.1
Manufacturing Industrial Production (% change)	-1.4	0.2	5.5	2.9	4.7	1.3	3.5	1.4	7.8	11.2	2.8	3.0	4.8
Common Market	1.0	2.2	2.4	4.1	3.0	1.4	2.9	1.1	0.8	3.0	2.8	2.4	1.3
Japan	11.6	4.9	1.4	4.1	0.7	11.4	3.8	2.1	3.5	11.0	5.6	4.5	1.8
Employment(millions)(civilian:household basis)	106.0	106.6	107.1	107.5	107.9	108.2	108.4	108.6	100.8	105.0	107.3	108.5	110.5
Percent Change	2.5	2.6	1.6	1.7	1.5	1.1	0.8	0.5	1.3	4.1	2.2	1.1	1.8
Unemployment Rate (%) (civilian)	7.2	7.3	7.3	7.3	7.4	7.5	7.7	7.9	9.6	7.5	7.3	7.8	7.8
Personal Income per Household (average)<1>	39,454	40,056	40,417	40,956	41,410	41,977	42,370	42,904	35,415	38,526	40,710	42,616	45,172
Percent Change -- Year Ago (w/o inflation)	4.8	3.4	2.1	2.0	1.5	1.7	1.6	1.4	1.5	5.4	2.3	1.4	1.9
Personal Taxes per Household (average)	7,166	7,391	7,468	7,582	7,674	7,778	7,856	7,975	6,478	6,956	7,529	7,911	8,405
Percent Change -- Year Ago (w/o inflation)	5.7	5.7	4.7	4.5	3.7	2.4	2.1	1.9	-3.0	3.5	4.6	1.9	2.2
Percent of Personal Income	19.0	19.3	19.3	19.4	19.4	19.4	19.4	19.4	19.1	18.8	19.3	19.4	19.5
Disposable Income per Household (average)	32,288	32,665	32,949	33,374	33,737	34,199	34,514	34,929	28,938	31,571	33,181	34,705	36,767
Percent Change--Year Ago (w/o inflation)	4.6	3.0	1.8	1.7	1.3	1.6	1.6	1.3	2.5	5.7	1.9	1.3	1.9
Household Interest Payments (% of total)	10.4	10.4	10.5	10.8	10.8	10.7	10.7	10.7	9.8	10.4	10.6	10.6	9.9
Net Worth Per Household (average)	79,817	81,597	83,561	85,767	87,333	89,892	90,690	92,493	73,838	77,705	84,564	91,366	97,303
Percent Change--Year Ago (w/o inflation)	2.5	4.0	5.7	5.2	5.9	7.2	5.3	4.5	7.6	1.4	5.2	4.8	2.4
Consumer Price Inflation (CPI)	3.5	3.1	3.5	3.3	3.4	3.6	3.6	3.7	3.2	4.3	3.4	3.5	4.3
Gross National Product Inflation (GNP Deflator)	2.8	5.1	2.0	3.0	3.1	3.1	3.1	3.5	3.8	3.8	3.4	3.1	4.0
Personal Consumption Inflation	2.4	3.6	3.0	2.8	3.1	3.2	3.3	3.4	3.7	3.2	3.1	3.2	4.0
Residential Construction Inflation	0.9	1.4	1.7	2.7	3.3	3.5	3.9	3.7	1.7	3.9	2.6	3.4	4.5
Nonresidential Construction Inflation	1.1	0.2	2.2	3.0	3.4	3.8	3.7	3.7	-1.0	0.3	1.6	3.5	4.5
Producers Price Inflation (WPI)	0.5	-2.1	1.3	1.8	2.3	2.6	2.5	2.9	1.3	2.4	0.2	2.4	3.7
Compensation per Manhour (% change)	3.6	6.2	3.9	4.1	4.6	5.3	4.4	4.6	4.8	4.2	4.4	4.6	5.8
Productivity (% change)	2.7	1.2	2.0	1.6	1.6	1.2	1.1	1.4	3.4	2.8	1.7	1.4	1.8
Unit Labor Cost (% change)	0.8	5.0	1.8	2.4	3.0	4.0	3.2	3.1	1.3	1.4	2.7	3.2	3.9
Unit Capital Cost (% change)	4.3	4.1	3.8	3.5	3.1	2.7	2.4	2.1	6.9	4.6	3.6	2.3	1.7
Before Tax Corporate Profits ($ billions)<2>	238	230	235	228	234	221	227	210	213	244	232	221	250
Corporate Tax Liability	95	89	91	87	90	85	88	79	86	98	89	85	99
After Tax Profits	142	141	145	141	144	136	139	131	127	146	143	136	151
Inventory Valuation Adjustment	-2	5	-2	-9	-11	-13	-13	-15	-11	-6	-4	-14	-22
Capital Consumption Adjustment	65	70	76	81	86	89	92	93	33	56	78	92	89
Profits from Current Production (with IVA, CCA)	205	216	218	213	219	212	217	210	149	196	216	214	219
Adjusted for Inflation (84:3 base)	204	212	213	207	210	202	205	197	156	197	210	202	198
Percent Change - Year Ago	12.8	12.5	8.2	3.4	3.1	-4.5	-3.6	-4.5	46.0	26.7	6.7	-4.1	-1.8
Per Unit of Output (% of GNP)	5.5	5.6	5.6	5.4	5.5	5.3	5.3	5.1	4.5	5.4	5.5	5.2	5.0
Effective Corporate Tax Rate (%)<2>	30	28	28	28	28	28	28	26	34	32	28	27	30
Federal Tax Receipts (Unified basis)	665	657	846	751	690	685	932	763	613	683	736	777	841
Percent of GNP	17.7	17.1	21.8	19.1	17.3	17.0	22.9	18.5	18.6	18.7	18.9	18.9	19.1
Federal Expenditures (Unified basis)	954	934	943	959	966	980	989	1,005	803	868	951	1,001	1,071
Percent of GNP	25.4	24.4	24.3	24.4	24.3	24.3	24.3	24.4	24.3	23.7	24.3	24.4	24.3
Surplus or Deficit (Unified basis)	-290	-278	-97	-208	-276	-295	-57	-242	-190	-184	-215	-224	-230
% of GNP	7.7	7.3	2.5	5.3	6.9	7.3	1.4	5.9	5.8	5.0	5.5	5.5	5.2
% of Personal Savings	177.7	194.9	71.4	152.6	204.0	215.8	43.5	186.9	158.1	117.2	155.7	174.1	162.2
% of Net Domestic Savings	85.0	83.7	29.5	65.8	85.7	96.6	18.5	84.2	80.0	56.4	66.2	75.7	73.7

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 4

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	84:4	85:1	85:2	85:3	83:4	86:1	86:2	86:3	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	3,826	4,063	4,248	4,320	4,229	4,173	4,148	3,946	3,730	3,936	4,215	4,038	3,849
Percent Change -- Year Ago	0.5	-1.8	4.7	16.0	10.5	2.7	-2.4	-8.6	42.4	5.0	7.1	-4.2	-4.7
Existing Single-Family Home Sales (thousands)	2,813	2,977	3,099	3,200	3,125	3,100	3,075	2,899	2,716	2,866	3,100	2,975	2,783
Percent Change - Year Ago	1.0	2.1	4.2	15.8	11.1	4.1	-0.8	-9.4	36.3	5.5	8.2	-4.1	-6.4
Dollar Volume (billions)	242.2	259.2	274.2	283.3	270.4	273.1	277.2	263.1	224.2	247.1	271.8	266.1	257.5
Existing Home Prices - Median ($1000's)	72.0	73.6	75.4	76.0	74.6	76.3	78.4	79.1	69.8	72.3	74.9	77.8	81.0
Percent Change - Year Ago	2.8	3.2	3.7	3.8	3.7	3.7	3.9	4.1	3.2	3.5	3.6	3.9	4.1
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	656	647	644	653	637	651	669	695	633	665	645	675	722
Percent of Median Family Income	30	29	29	29	28	28	29	29	32	31	29	29	29
Private Housing Starts (thousands)	1,398	1,734	1,826	1,809	1,798	1,765	1,763	1,727	1,703	1,766	1,792	1,750	1,745
Percent Change - Year Ago	-6.9	-10.9	-1.7	8.8	12.5	1.8	-3.5	-4.5	61.0	3.8	1.4	-2.3	-0.3
Single-Family	1,045	1,119	1,183	1,155	1,138	1,106	1,107	1,080	1,066	1,103	1,149	1,097	1,099
Percent of Total	65.4	64.6	64.9	63.8	63.3	62.7	62.8	62.5	62.6	62.4	64.1	62.7	62.9
Multi-Family	353	615	642	655	660	659	656	647	637	664	643	653	646
Percent of Total	34.6	35.4	35.1	36.2	36.7	37.3	37.2	37.5	37.4	37.6	35.9	37.3	37.1
Mobile Home Shipments	292	275	292	302	313	315	331	321	296	295	295	323	319
New Single-Family Home Sales (thousands)	617	629	660	668	624	631	623	612	627	637	645	614	588
Percent Change - Year Ago	-8.8	-7.9	4.3	8.7	1.1	0.3	-5.6	-8.3	49.9	1.5	1.3	-4.8	-4.2
New Home Prices - Median ($1000's)	80.3	82.2	82.7	83.5	84.4	85.4	86.4	87.5	75.5	80.0	83.2	87.0	91.8
Percent Change - Year Ago	5.8	3.4	2.8	2.7	5.2	4.0	4.5	4.7	8.9	6.0	4.0	4.5	5.6
New Home Prices--Mean ($1000's, Quality Adjusted)	95.0	95.1	95.4	96.7	97.1	97.7	98.6	100.2	89.7	93.6	96.1	99.3	103.8
Percent Change - Year Ago	5.3	4.5	2.1	1.7	2.3	2.8	3.3	3.6	2.1	4.4	2.6	3.4	4.5
NAR Affordability Index	86.2	87.9	86.8	91.7	89.0	89.8	87.9	88.9	82.0	86.2	88.8	88.9	89.9
New Mortgage Commitments ($ billions)	195.6	183.4	181.3	186.8	190.8	203.9	189.8	198.5	163.4	193.0	185.6	195.4	213.3
Percent Change - Year Ago	19.2	-4.1	-12.2	4.4	-2.5	11.2	4.7	6.3	152.1	18.1	-3.9	5.3	9.2
Mortgage Debt Outstanding ($ billions)	2,033	2,127	2,224	2,310	2,405	2,328	2,290	2,255	1,752	1,953	2,266	2,282	2,287
Homeowners' Equity ($ billions)<1>	1,480	1,496	1,511	1,527	1,547	1,569	1,593	1,617	1,553	1,503	1,520	1,606	1,704
Housing Inventory (millions)	91.7	92.0	92.4	92.7	93.1	93.5	93.9	94.3	89.6	91.1	92.6	94.1	95.6
Rental Vacancy Rate (%)	6.3	6.2	6.1	6.0	5.8	5.8	5.8	5.8	5.6	5.9	6.0	5.8	5.8
Unsold New Homes (% of sales)	55.4	53.3	59.7	61.9	69.3	69.2	75.1	68.7	42.9	50.7	61.0	71.1	69.5
Office Vacancy Rate (%)<2>	14.7	10.7	10.4	10.1	9.9	9.7	9.5	9.4	11.7	13.9	10.3	9.5	9.1
Industrial Vacancy Rate (%)<2>	4.7	4.0	3.9	3.8	3.8	3.7	3.7	3.6	4.9	4.7	3.9	3.6	3.4
New Commercial Building Construction (% Ch Value)	50.8	33.6	-2.0	3.8	-0.1	5.0	-1.5	2.5	-4.2	37.1	20.7	1.3	2.7
New Industrial Building Construction (% Ch Value)	23.0	12.1	21.2	8.1	22.1	9.9	19.8	0.8	-25.7	11.6	15.1	14.4	18.3
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	3.3	11.3	5.5	5.6	5.4	6.0	5.3	6.1	11.2	6.9	8.4	5.6	5.5
M1 Velocity (% change)	3.7	-3.1	-0.4	-0.1	0.0	-1.0	-0.6	-1.5	-3.2	3.7	0.1	-0.6	1.7
M2 (% change)(FED Target 6-9%)	9.3	13.0	7.6	5.2	5.6	6.2	7.1	7.3	12.5	7.9	8.7	6.4	6.7
M2 Velocity (% change)	-2.0	-4.7	-2.4	0.3	-0.3	-1.2	-2.3	-2.6	-4.4	2.7	-2.0	-1.3	0.6
Monetary Base (% change)	4.5	8.7	4.4	5.5	4.8	5.5	4.8	5.6	9.5	8.1	6.2	5.1	5.9
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	653	666	676	668	685	694	708	676	479	654	674	692	747
Private													
Personal Savings	163	143	135	137	135	137	131	130	118	156	137	130	141
Savings Rate	6.2	5.3	5.0	5.0	4.8	4.8	4.6	4.5	5.0	6.1	5.0	4.5	4.6
Gross Business Savings	536	551	557	556	566	564	575	575	454	519	557	576	610
Government													
Federal	-197	-184	-188	-193	-199	-186	-189	-211	-179	-176	-191	-200	-208
State and Local	56	58	61	58	59	51	56	46	44	53	59	52	59
Foreign (current account deficit)	95	99	111	115	124	128	134	137	42	102	112	135	145
Uses (total:gross investment)	638	649	662	661	672	675	681	651	472	638	661	669	727
Nonresidential Investment													
Equipment	290	293	298	303	310	316	323	329	223	275	301	326	362
Structures	158	161	161	163	166	168	171	173	130	150	163	172	187
Residential Investment	154	156	159	164	166	166	167	168	132	154	161	168	176
Inventory Investment	37	38	44	30	31	25	21	-19	-13	58	36	3	3
Value of the U.S. Dollar (Weighted by Trade) (Base-1967)	1.143	1.201	1.175	1.155	1.135	1.116	1.098	1.081	1.024	1.095	1.167	1.090	1.028
Percent Change	8.9	22.0	-8.5	-6.5	-6.7	-6.6	-6.5	-5.9	3.7	6.9	6.6	-6.6	-5.7
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	14.0	13.5	13.1	13.2	13.1	13.1	13.1	13.5	13.8	14.2	13.2	13.3	13.7
Real Mortgage Rate (30 yr. avg. is 4.5%)	11.3	8.4	11.0	10.2	10.0	10.0	10.0	10.0	10.2	10.5	9.9	10.0	9.8
1 Year ARM (without buy-down)	11.7	11.2	11.4	11.4	11.4	11.5	11.4	11.2	11.3	12.6	11.3	11.4	11.6
Real Mortgage Rate	9.0	6.1	9.4	8.4	8.3	8.4	8.3	7.7	7.5	9.0	8.0	8.0	7.2
Corporate Bond Rate (AAA)	12.3	12.2	12.2	12.3	12.3	12.3	12.4	12.4	12.0	12.7	12.2	12.4	12.8
Government Bond Rate	11.8	11.7	11.6	11.7	11.8	11.8	11.8	11.9	11.3	12.5	11.7	11.9	12.2
Real Government Bond Rate (30 yr. avg. is 2.1%)	9.0	6.6	9.6	8.7	8.7	8.7	8.7	8.4	7.6	8.9	8.4	8.5	7.8
Federal Funds Rate	9.3	8.6	8.7	9.0	9.2	9.3	9.3	9.5	9.1	10.2	8.9	9.3	9.9
3 Month Treasury Bill Rate	8.8	8.3	8.5	8.6	8.7	8.8	8.9	9.0	8.6	9.5	8.5	8.8	9.0
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	6.1	3.2	6.5	5.6	5.6	5.7	5.8	5.5	4.8	5.9	5.2	5.5	4.6
1 Year Treasury Bill Rate	10.0	9.5	9.7	9.7	9.7	9.8	9.7	9.5	9.6	10.9	9.6	9.7	9.9
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	7.3	4.4	7.7	6.7	6.6	6.7	6.6	6.0	5.8	7.3	6.3	6.3	5.5
Commercial Paper Rate	9.2	8.6	8.8	9.0	9.1	9.2	9.2	9.1	8.9	10.1	8.9	9.2	9.8
Rate on Money Market Fund Shares	9.3	8.7	8.9	9.1	9.2	9.4	9.3	9.2	9.0	10.3	9.0	9.3	9.8
Prime Rate	11.8	10.6	10.9	10.9	10.9	11.4	11.4	11.3	10.8	12.0	10.8	11.3	11.7

<1> Homeowners Equity has been adjusted to correspond to the Federal Reserve's Flow of Funds data.
<2> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

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MAY 1985

Outlook for the Economy and Real Estate

Aggregate Economy

As the current expansion winds down from the strong pace of the last two years and the trade situation continues to deteriorate, economic activity is expected to remain sluggish through 1985. The downward revision in the first quarter real (inflation-adjusted) growth in GNP to an annualized rate of 1.3 percent underscores slowing growth in nearly all sectors of the economy.

Just as consumer spending led the recovery, a slowdown in this component is now bringing the economy to a soft landing. Because spending increases have exceeded income gains by as much as 75 percent over the last four months, consumers are now trying to reduce their debt burdens. Thus, a subsequent decline in the personal savings rate and an inevitable fall in consumption has begun to occur. In contrast to the high levels of expenditures on durables that occured in 1984, the growth rate for durables during the first quarter of 1985 of 6.9 percent was only half of the growth experienced last year. Growth in total consumption is expected to slow through 1985 from the strong pace of 1984 and will therefore put further downward pressure on overall output growth of the economy during 1985 and 1986.

Growth in business fixed investment, which provided a strong stimulus to the current recovery, is also beginning to show signs of weakening as slower economic activity and domination of foreign produced capital goods widens the gap between domestic consumption and production. This had led to an undesirable accumulation of domestic inventories in manufacturing and capital goods during the first quarter. In addition, the key determinants of business fixed investment, capacity utilization and corporate profits, have begun to falter leading to a pronounced decline in capital spending during the first quarter. Furthermore, a March decline in new orders for nondefense capital goods, which is usually a good indicator of future capital spending, underscores the continued slowing in investment that is expected through 1985 as both productivity and corporate profits continue to decline.

The major source of the recent weakening in consumer and investment demand has been the continued deterioration in the trade balance. According to the first quarter estimates net exports have declined 26.1 billion, almost twice the fourth quarter decline and an indication of a worsening trade situation during 1985 and 1986. Unfortunately, the recent decline in the dollar is not likely to lead to improvement without a lag of a year or two. The dollar's decline is relative to a peak that lasted only a couple of weeks in February and that "spike" had no direct impacts on trading patterns. In addition, since the lag between foreign orders and deliveries is a minimum of nine months, today's strong import penetration reflects the value of the dollar last summer. Consequently, any improvement in the trade situation would have to accompany a sustained drop in the dollar to levels well below the 2.75 dollar/deutsche mark rate reached last year.

Low inflation and declining interest rates should prevent the economy from entering a full recession as modest gains in the interest sensitive sectors of the economy such as business fixed investment, residential construction, and consumer durables should provide a positive stimulus to output growth through 1985. However, given the current trade imbalance and the maturity of the expansion, the economy is expected to grow below 2 percent for the remainder of the year before increasing to around 2.3 percent by 1986. By 1987, a gradual depreciation in the dollar should lead to some renewed growth in the economy with total output growth expected to reach 3.5 percent.

Employment and Inflation

Employment in March remained strong with total nonfarm employment increasing a marked 0.4 percent. The improvement in the employment figures can be attributed to strong growth in the service producing sector while employment in manufacturing was little changed. In addition, the civilian unemployment rate in March remained unchanged at 7.3 percent. However, as the economy continues to slow, growth in employment is also expected to decline leading to a gradual increase in the civilian unemployment rate through 1985 as the number of jobs available falls short of new additions to the labor force.

Despite fears of a devalued dollar and slower economic growth pushing prices higher, the short-term outlook for inflation remains favorable. The 0.4 percent increase in the Consumer Price Index (CPI) in March can be attributed to a sharp turnaround in gasoline prices and does not indicate any renewed inflationary pressures for 1985. For all of 1985 consumer prices are expected to increase a modest 3.5 percent followed by 3.7 percent in 1986. By 1987, a gradual devaluation of the dollar from record highs should boost consumer inflation to around 4.3 percent.

Monetary Policy and Interest Rates

After rapid growth in the money supply over the last four months, growth in M1, M2 and M3 has begun to subside with growth rates in March remaining well below their upper targets. This slowing in the money supply underscores the need for a more accomodative monetary policy by the Federal Reserve as economic activity continues to slow.

The goods news about slower economic activity is the subsequent decline in interest rates that will occur as demand continues to weaken. Short term rates after rising in February and March have begun to trend downward. In fact, the rate on 3-month T-bills dipped to its lowest level in two years well below 8 percent in late April. By the second half of 1985, however, rates will begin to drift upward again as mounting federal deficits and a slight rebound in demand will put upward pressure on rates. Long term rates are also expected to trend downward as inflationary expectations remain modest. By the end of 1986, long term rates will begin to trend upward.

Real Estate Markets

Activity in the housing market continues to mark record gains for the 1980's as lower interest rates and moderate inflation provide a boost to affordability for potential homebuyers. Existing home sales climbed to their highest level in 4-1/2 years reaching a seasonally-adjusted annual rate of 3.05 million units in March and are expected to reach a seasonally-adjusted annual rate of 3.1 million units for all of 1985. By 1986, existing home sales should remain strong at 3.0 million units before declining to 2.8 million units in 1987.

Total housing starts also recorded strong gains in March with total starts increasing 16.2 percent. However, most of the increase is due to the extreme volatilty that has occurred in the multi-family starts since December. In March, multi-family starts increased 46 percent after declining 33 percent in February. Total starts are expected to reach a seasonally-adjusted annual rate of 1.8 million units for all of 1985 before declining slightly into 1986 as interest rates begin to trend upward.

Continued declines in mortgage interest rates and improvements in family income helped boost NAR's Affordability Index to 89.4 in March--the highest level in more than 5 years. A decline of nearly 0.25 percentage points in the average effective commitment rate in February was the major reason for the improvement in affordability.

Most components of nonresidential construction are not expected to fare as favorably as residential construction in 1985. The office building boom appears to be receeding from an extraordinary peak and as a result over-building in office space has held the office vacancy rate near 10 percent. Therefore, an extended correction over the next couple of years will dominate with office construction expected to decline from 317 million square feet in 1984 to 275 million square feet for all of 1985.

The strongest component of nonresidential construction will be stores and other commercial construction. The already high levels in retail building are expected to be sustained through 1985 given the strong growth in housing starts that is forecasted. Almost 500 million square feet of retail and other commercial buildings are expected to be contracted in 1985 compared with 477 million square feet in 1984.

Industrial construction, in response to slowing corporate profits and productivity, is also expected to show only modest gains with 150 million square feet expected in 1985, only 4 percent above 1984's levels.

Table 1

Commercial and Industrial Building Contracts

	Stores and Other Commercial		Office Buildings		Industrial Buildings	
	millions of sq ft	percent change	millions of sq ft	percent change	millions of sq ft	percent change
Year						
1981	337	-11%	325	+15%	187	-13%
1982	245	-27%	261	-20%	118	-37%
1983	362	+48%	281	+ 8%	107	-37%
1984	477	+32%	317	+13%	113	+33%
1985^{f}	496	+ 4%	275	-13%	150	+ 5%

Source: Historical Data: DRI, Review of the U.S. Economy, December 1984.
Forecasts: NATIONAL ASSOCIATION OF REALTORS®

f Forecast

Special Supplement

The Impact of Tax Reform on Real Estate

All three of the major tax reform proposals currently under consideration - the Kemp-Kasten "FAST" proposal, the Bradley-Gephardt "FAIR" proposal, and the Treasury Tax Reform Proposal now referred to as Treasury I - would make sweeping changes to the tax law pertaining to both owner-occupied housing and commerical real estate. 1/ This report presents the analysis of the likely impact of these tax reform proposals on these categories of real estate. Assuming that mortgage interest rates remain unchanged, in general tax reform would cause the after-tax cost of owner-occupied residences to rise, resulting in a decline in their value. The declines in value would be greater for higher-priced homes since the typical buyers of such properties would experience a larger decline in marginal tax rates than would the buyers of lower-priced homes. Similarly, tax reform would significantly reduce the yield on commercial real estate, reducing the level of investment in such properties. This in turn will reduce the value of such properties and result in signficant increases in rents in the long-run. Should tax reform cause mortgage interest rates to fall by 1 percentage point, the best that can be expected given the role of foreign investors in determining domestic interest rates, the dire impacts of tax reform on real estate would be only partially mitigated.

Owner-Occupied Homes

Table 2 presents a side-by-side comparison of the provisions of current tax law which impact the after-tax cost of homeownership with the tax reform proposals under discussion. Current law is expressed as it is believed it will be in 1986 when the zero bracket amount or standard deduction and exemptions are indexed for inflation.

In general, taxpayers would face lower marginal tax rates under any of the tax reform proposals than they do under current law. As a result, a given dollar amount of itemized deductions results in a reduced amount of tax savings. For example, where $1 of deduction results in $.25 of tax savings with a 25 percent marginal rate, tax savings are reduced to $.15 with a 15 percent marginal rate. The exeption to this generalization is for lower-income taxpayers under Kemp-Kasten where the 24% marginal rate on deductions frequently exceeds the marginal rate under current law. 2/

All three proposals would raise the taxpayer and spouse exemption. Kemp-Kasten and Treasury I would also raise the dependent exemption. Bradley-Gephardt keeps the dependent exemption at $1,000 which is less than 1986 current law since Bradley-Gephardt eliminates indexing. Increasing the value of exemptions tends to raise after-tax homeownership costs since, for a given level of gross income, larger exemptions result in lower taxable income and so are likely to result in a lower marginal tax rate.

Bradley-Gephardt raises the zero bracket amount (ZBA) or standard deduction for a joint return from $3,710 to $6,000 while Treasury I raises it to $3,800 but retains indexing. Increasing the ZBA also reduces the value of a given dollar amount of itemized deductions since it is the amount of such deductions above the ZBA by which taxable income is reduced. In contrast, Kemp-Kasten reduces the ZBA for joint returns, having the opposite effect.

TABLE 2

COMPARISON OF TAX PROVISIONS IMPACTING AFTER-TAX HOMEOWNERSHIP COSTS UNDER ALTERNATIVE TAX REFORM PROPOSALS

	1986 Current Law	Bradley-Gephardt	Kemp-Kasten	Treasury I
PERSONAL MARGINAL TAX RATES	14 rate brackets from 11 to 50%	3 rate brackets 14%, 26%, 30%	1 rate bracket 24%	3 rate brackets 15%, 25%, 35%
EXEMPTIONS				
Self, spouse	$1,090	$1,600	$2,000	$2,000
Dependents	$1,090	$1,000	$2,000	$2,000
Elderly	$1,090	$1,000	$2,000	Credit
Blind	$1,090	$1,000	$2,000	Credit
ZERO BRACKET AMOUNTS				
Single	$2,510	$3,000	$2,600	$2,800
Joint	$3,710	$6,000	$3,300	$3,800
Heads of Household	$2,510	$3,000	$2,700	$3,500
INDEXED RATE BRACKETS, EXEMPTIONS, AND ZBA	Yes	No	Yes	Yes
PERSONAL DEDUCTIONS				
Mortgage Interest				
Principle Residence	Yes	Yes	Yes	Yes
Secondary Residence	Yes	Yes	Yes	Treated as other personal interest.
Other personal interest	Yes	Limited to net passive investment income.	No, except on education expenses.	Limited to $5,000, plus passive investment income. Amount above $5,000 indexed for inflation.
Real Property Taxes	Yes	Yes	Yes	No
SPECIAL FEATURES	--	All deductions at 14% marginal rate	20% exclusion of employment income up to maximum taxable Social Security Income (indexed), phased out above that income level.	--

TABLE 2 (continued)

	1986 Current Law	Bradley-Gephardt	Kemp-Kasten	Treasury I
OTHER INDIVIDUAL ITEMS				
Rollover of Capital Gains on Principal Residence	Capital gain tax deferred if seller purchases another residence costing at least as much as the one sold within two years.	Yes	Yes	Yes
One-time Exclusion on Capital Gains on Principal Residence	One-time exclusion of gain up to $125,000 on sale of principal residence for taxpayers 55 or older.	Yes *	Yes	Yes, plus gain is indexed for inflation.
FINANCIAL INSTITUTIONS				
Special Bad Debt Reserve	Yes	No	No	No
MUNICIPAL BONDS				
Public purpose	Tax-exempt	Taxed-exempt	Tax-exempt	Tax-exempt
Private purpose	Tax-exempt	Taxed	Taxed	Taxed

Source: NATIONAL ASSOCIATION OF REALTORS

* Excluded from 14 percent base rate only. Not excluded from the 12 percent and 16 percent surtax rates.

All three proposals retain unlimited mortgage interest deductions for principal residences. Bradley-Gephardt and Kemp-Kasten also retain unlimited mortgage interest deductions for secondary residences while Treasury I lumps such deductions in with other personal interest deductions which are limited to $5,000 plus passive investment income were the amount of deductable interest above $5,000 is subject to inflation indexing. Bradley-Gephardt and Kemp-Kasten also retain deductions for real property taxes whereas Treasury I repeals such deductions. Note that while Bradley-Gephardt has a progressive marginal rate structure, all deductions are evaluated at the 14 percent base rate only.

Each of the proposals also retains the existing rollover of capital gains on the sale of a principal residence and the one-time exclusion of capital gains up to $125,000 on the sale of a principal residence by taxpayers 55 or older. However, both Bradley-Gephardt and Treasury I introduce some changes which alter the value of this exclusion. Under Bradley-Gephardt the value of the one-time exclusion is diminished since it applies to the 14 percent base rate but not the 12 and 16 percent surtax rates. Under Treasury I the value of the one-time exclusion is enhanced since the gain on the sale of a principal residence is indexed for inflation.

Tables 3 and 4 present estimated impacts of the various tax reform proposals on the after-tax cost of ownership of a principal residence. Estimates are provided for three home prices - $50,000, $85,000 and $150,000. In Table 3 the estimates are made holding interest rates constant while in Table 4 interest rates are assumed to decline by one percentage point due to the decline in marginal tax rates. 3/ The impacts on actual taxpayers are likely to be slightly different from these examples since they do not account for state income taxes or nonhousing itemized deductions.

If mortgage interest rates remain unchanged, under Treasury I the after-tax cost of owning a $50,000 home would rise about 4.8 percent, resulting in a 5.1 percent decline in the value of this property. Under Kemp-Kasten the after-tax cost of owning this same home would fall about 3.7 percent, resulting in a 4.4 percent increase in value, while under Bradley-Gephardt that cost would rise by about 8.0 percent with value declining 8.6 percent. If mortgage rates were to fall one percentage point the after-tax cost of owning this $50,000 home would fall 1.1 percent under Treasury I, fall 9.0 percent under Kemp-Kasten, and rise 1.5 percent under Bradley-Gephardt. The corresponding impacts on the value of this property would be plus 1.2 percent, plus 11.6 percent, and minus 1.7 percent. 4/

The impact on higher-priced homes is much more severe due to the larger decline in marginal tax rates. For example, with mortgage rates unchanged, under Bradley-Gephardt the after-tax cost of owning a $150,000 home would rise by 30.7 percent, resulting in a 24.7 percent decline in value. Under Treasury I the after-tax cost of this same property would rise 21.5 percent, causing value to decline 18.8 percent. Under Kemp-Kasten, after-tax cost would rise 16.0 percent and value would decline by 14.5 percent. With a one percentage point decline in mortgage rates Bradley-Gephardt would result in a 22.3 percent increase in after-tax cost and 19.5 percent decline in value. Under Treasury I the corresponding impacts are plus 14.5 percent and minus 13.6 percent while under Kemp-Kasten they are plus 8.8 percent and minus 8.6 percent.

TABLE 3

COMPARISON OF AFTER-TAX HOMEOWNERSHIP COSTS UNDER ALTERNATIVE TAX REFORM PROPOSALS [1]
(MORTGAGE RATES UNCHANGED)

EXAMPLE #1

Cost of Home - $50,000
Required Income - $21,500

	Current Law	Treasury I	Kemp-Kasten	Bradley-Gephardt
Before Tax Cost ($)	$6,200	$6,200	$6,200	$6,200
Marginal Tax Rate (%)	18%	15%	24%	14%
Tax Savings ($)	487	210	696	28
After Tax Cost ($)	5,713	5,990	5,504	6,172
Change in Cost ($)	- -	+277	-209	+459
Change in Cost (%)	- -	+4.8%	-3.7%	+8.0%
Change in Home Value (%)	- -	-5.1%	+4.4%	-8.6%
Impact on Home Sales (%)	- -	-10%	+8%	-17%

EXAMPLE #2

Cost of Home - $85,000
Required Income - $36,000

	Current Law	Treasury I	Kemp-Kasten	Bradley-Gephardt
Before Tax Cost ($)	$10,540	$10,540	$10,540	$10,540
Marginal Tax Rate (%)	25%	15%	24%	14%
Tax Savings ($)	1,851	756	1,738	636
After Tax Cost ($)	8,689	9,784	8,802	9,904
Change in Cost ($)	- -	+1,095	+113	+1,215
Change in Cost (%)	- -	+12.6%	+1.3%	+14.0%
Change in Home Value (%)	- -	-11.9%	-1.4%	-13.4%
Impact on Home Sales (%)	- -	-24%	-2%	-26%

EXAMPLE #3

Cost of Home - $150,000
Required Income - $ 64,000

	Current Law	Treasury I	Kemp-Kasten	Bradley-Gephardt
Before Tax Cost ($)	$18,600	$18,600	$18,600	$18,600
Marginal Tax Rate (%)	38%	25%	24%	14%
Tax Savings ($)	5,718	2,950	3,672	1,764
After Tax Cost ($)	12,882	15,650	14,928	16,836
Change in Cost ($)	- -	+2,768	+2,046	+3,954
Change in Cost (%)	- -	+21.5%	+16.0%	+30.7%
Change in Home Value (%)	- -	-18.8%	-14.5%	-24.7%
Impact on Home Sales (%)	- -	-34%	-25%	-48%

[1] All examples assume a 20 percent downpayment, a 30 year fixed rate mortgage with a 13 percent interest rate, and property taxes equal to 2 percent of the home value. Required income assumes 25 percent of income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

TABLE 4

COMPARISON OF AFTER-TAX HOMEOWNERSHIP COSTS UNDER ALTERNATIVE TAX REFORM PROPOSALS 1/
(MORTGAGE RATES DECLINE BY ONE PERCENTAGE POINT)

EXAMPLE #1

Cost of Home - $50,000
Required Income - $21,500

	Current Law	Treasury I	Kemp-Kasten	Bradley-Gephardt
Before Tax Cost ($)	$6,200	$5,800	$5,800	$5,800
Marginal Tax Rate (%)	18%	15%	24%	14%
Tax Savings ($)	487	150	600	0
After Tax Cost ($)	5,713	5,650	5,200	5,800
Change in Cost ($)	- -	-63	-513	+87
Change in Cost (%)	- -	-1.1%	-9.0%	+1.5%
Change in Home Value (%)	- -	+1.2%	+11.6%	-1.7%
Impact on Home Sales (%)	- -	+3%	+18%	-4%

EXAMPLE #2

Cost of Home - $85,000
Required Income - $36,000

	Current Law	Treasury I	Kemp-Kasten	Bradley-Gephardt
Before Tax Cost ($)	$10,540	$ 9,860	$ 9,860	$ 9,860
Marginal Tax Rate (%)	25%	15%	24%	14%
Tax Savings ($)	1,851	654	1,574	540
After Tax Cost ($)	8,689	9,206	8,286	9,319
Change in Cost ($)	- -	+517	-403	+630
Change in Cost (%)	- -	+6.0%	-4.6%	+7.3%
Change in Home Value (%)	- -	-6.0%	+5.4%	-7.4%
Impact on Home Sales (%)	- -	-11%	+9%	-14%

EXAMPLE #3

Cost of Home - $150,000
Required Income - $ 64,000

	Current Law	Treasury I	Kemp-Kasten	Bradley-Gephardt
Before Tax Cost ($)	$18,600	$17,400	$17,400	$17,400
Marginal Tax Rate (%)	38%	25%	24%	14%
Tax Savings ($)	5,718	2,650	3,384	1,596
After Tax Cost ($)	12,882	14,750	14,016	15,804
Change in Cost ($)	- -	+1,868	+1,134	+2,992
Change in Cost (%)	- -	+14.5%	+8.8%	+22.3%
Change in Home Value (%)	- -	-13.6%	-8.6%	-19.5%
Impact on Home Sales (%)	- -	-23%	-14%	-36%

1/ All examples assume a 20 percent downpayment, a 30 year fixed rate mortgage with a 13 percent interest rate, and property taxes equal to 2 percent of the home value. Required income assumes 25 percent of income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

At this point it is important to address two common misconceptions about the impact of tax reform on homeownership. First, it has been suggested that homeownership would not be adversely affected by tax reform for even though after-tax homeownership costs may rise, it is also true that a taxpayers disposable or after-tax income will also rise, offsetting the increase in homeownership costs. Second, it has been suggested that the resulting decline in home prices will improve affordability and therefore aid first-time homebuyers and current homeowners who wish to move up the housing ladder.

In regard to the first misconception, it is important to note that the tax savings provided by the homeownership deductions are conditional upon owning a home and so must be used to reduce the cost of owning that home. Therefore, implicitly a homeowner pays the same tax and has the same disposable income as a renter with the same income, exemptions, non-housing itemized deductions, etc. Using Treasury I as an example, Table 5 presents the impacts of tax reform on a homeowner with an adjusted gross income of $36,000 who owns an $85,000 home under the assumptions described in Table 3. Treasury I would actually boost this homeowners implicit disposable income by $1,755 but raise after-tax homeownership costs by $1,095. After-tax homeownership costs would rise from 28.4 percent of disposable income to 30.2 percent, reflecting the increase in the relative price of homeownership. The net impact is that this homeowner would have $660 of additional disposable income to spend on other goods and services. However, this amount would decline to $200 to $300 when the decline in value of all other itemized deductions is taken into account. The bottom line is that the price of homeownership would rise relative to the price of all other goods and services, leading consumers to demand less of it.

Table 5

NET IMPACT OF TREASURY TAX PLAN ON HOMEOWNING TAXPAYER
FAMILY OF FOUR, FILING JOINTLY
(Taxable Year 1984)

	Current Law	Treasury Plan	Change
Adjusted gross income	$36,000	$36,000	--
Income tax without homeownership tax deductions	5,385	3,630	-1,755
Disposable income	30,615	32,370	+1,755
After-tax cost of homeownership	8,689	9,784	+1,095
Percent of disposable income	28.4%	30.2%	+1.8%
Disposable income available for all other goods and services	21,926	22,586	+660

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

The notion that affordability would be enhanced by the decline in home prices is also incorrect upon closer examination. Home prices would decline so that the after-tax cost of owning a home under the new tax laws would equal the after-tax cost under current law. Thus, it will still cost about $880 per month for principal, interest and property taxes to own a home that currently costs $85,000 even though the price of that home falls to about $75,000 under Treasury I, for example. Thus, the ability of first-time buyers to purchase a home would not be improved.

Existing homeowners would find their ability to move up the housing ladder actually diminished by tax reform. A recent survey of homebuyers conducted by the NATIONAL ASSOCIATION OF REALTORS® revealed that on average the equity-value ratio of homes sold by repeat homebuyers was 45 percent. Further, it was found that on average homebuyers who trade up to a more expensive property purchase a home costing about 47 percent more than the home they sell. Table 6 uses this information to compare the position of a repeat buyer before and after enactment of Treasury I. Under current law, the owner of a home currently valued at $85,000 would have about $38,000 of equity to use toward the purchase of a $125,000 home. This homebuyer would require a mortgage loan of $87,000, resulting in before-tax interest and property taxes of $13,810. With tax savings of $3,434 the after-tax cost is $10,376.

If Treasury I were enacted and interest rates remained constant, the value of the current home would fall about 12 percent to $75,000, causing equity to decline by 26 percent. The home this repeat buyer is likely to buy would fall about 14 percent to $107,600. With $28,000 in equity the repeat buyer would now require a mortgage loan of $79,600, 9 percent less than under current law. However, with a lower marginal tax rate, larger ZBA, and property taxes no longer deductible, the after-tax cost of owning the same property would be 5 percent higher. Note that even if mortgage rates were to decline by one percentage point, the after-tax cost would still be increase by 2 percent due to Treasury I.

Commercial Real Estate

Table 7 presents a side-by-side comparison of the provisions of current tax law which effect the yield on investments in commercial real estate with their status under the three main tax reform proposals. Table 8 presents estimates of the impact of each of the proposals on a typical commercial property.

Compared to Treasury I, Bradley-Gephardt and Kemp-Kasten make relatively few changes to current law and would have relatively modest impacts on a typical commercial investment. The primary changes introduced by Bradley-Gephardt are to reduce the maximum marginal tax rate for both personal and corporate taxpayers to 30 percent, adopt a 40 year depreciation period for structures while accelerating the depreciation method to 250 percent declining balance, and eliminate the 60 percent capital gains exclusion without indexing asset basis for inflation. Assuming interest rates remain unchanged, Bradley-Gephardt would cause the first-year taxable income of a typical commercial real estate investment to rise by 21 percent, the first-year after-tax cash flow to decline 57 percent, the 10-year internal rate of return (IRR) to decline 25 percent, and the 10-year net present value (NPV) to decline 52 percent. With the reduction in yield it is estimated that the annual rate of investment in commercial real estate would decline by 12 percent, which in the long-run would cause commercial rents to rise by 10 percent, at which point the yield on this type of property would be restored to levels experienced under current law. If mortgage rates fell by one percentage point the 10-year IRR would decline by 17 percent while in the long-run rents would rise by 7 percent.

TABLE 6

IMPACT OF TREASURY I ON A REPEAT HOMEBUYER

	Home Owned			Home to Buy (Mortgage Rates Unchanged)			Home to Buy (Mortgages Rates Decline By One Percentage Point)		
	Current Law	Treasury I	Difference	Current Law	Treasury I	Difference	Current Law	Treasury I	Difference
Value	$85,000	$ 75,000	-12%	$125,000	$107,600	-14%	$125,000	$114,600	- 8%
Equity	38,000	28,000	-26%	38,000	28,000	-26%	38,000	32,900	-13%
Loan	47,000	47,000	---	87,000	79,600	- 9%	87,000	81,700	- 6%
Interest 1/	---	---		11,310	10,348	- 9%	11,310	9,804	-13%
Property Tax 2/	---	---		2,500	2,152	-14%	2,500	2,292	- 8%
Before-tax Cost	---	---		13,810	12,500	- 9%	13,810	12,096	-12%
Marginal Tax Rate 3/	---	---		34%	25%	--	34%	25%	---
Tax Savings	---	---		3,434	1,637	-52%	3,434	1,501	-56%
After-tax Cost	---	---		$ 10,376	$10,863	5%	$ 10,376	$ 10,595	2%

SOURCE: NATIONAL ASSOCIATION OF REALTORS

1/ Based on a 13 percent interest rate.

2/ Two percent of property value.

3/ Based on a required income of $46,200, joint return with four exemptions.

Kemp-Kasten would reduce the maximum personal marginal tax rate to 24 percent while the maximum corporate marginal tax rate would be reduced to 35 percent. The depreciation period would be lengthened to 25 years but 6 percent of the original basis could be deducted in each of those 25 years. Furthermore, that 6 percent of original basis would be indexed for inflation. The Kemp-Kasten depreciation system is more favorable than current law and, in a present value sense, approximates first-year expensing of original basis. In regard to captial gains, Kemp-Kasten would provide the taxpayer with the option of a 40 percent exclusion or no exclusion but the asset value would be indexed for inflation so that tax is paid on only real or inflation-adjusted gain rather than nominal gain. These changes would reduce the 10-year IRR by about nine percent and boost rents in the long-run by about four percent. If mortgage interest rates fell by one percentage point, the 10-year IRR would decline by just two percent with rents rising just one percent in the long-run.

Treasury I would make changes similar to Kemp-Kasten but would in addition introduce several novel proposals detrimental to real estate. Treasury I would reduce the maximum marginal personal tax rate to 35 percent and the maximum marginal corporate rate to 33 percent. Depreciation of structures would be limited to 3 percent of the adjusted basis where this adjusted basis is indexed for inflation. The current capital gains exclusion would be repealed. Capital gains would be taxed as ordinary income, but the basis for computing capital gains would be indexed for inflation. In addition, Treasury I would introduce the indexing of interest indebtedness for inflation, where at positive rates of inflation a fraction of interest expense would be nondeductible and an equal fraction of interest income would not be taxed. At 5 percent inflation, the rate assumed in Table 8, 45 percent of interest expense would be nondeductible. Treasury I would also extend the "at risk" rule to real estate, whereby the losses from an investment which can be used to shelter other sources of income are limited to invested capital and recourse financing. Referring to Table 8, the net effect of these proposals, shown as Case A under Treasury I, would be to turn first-year taxable income from negative to positive, turn first year after-tax cash flow from positive to negative, reduce the 10-year IRR by 39 percent, and cause rents to rise by 20 percent in the long-run. Under Case A this investment is operated as the investor's trade or business, so that the investor is regarded as being active in the management of the investment. Under Case B the investor is passive, such as a limited partner, so that the investor's share of the interest expense of the property falls under the limits of other personal interest deductibility.[5] In this case virtually all interest expense is nondeductible, further reducing the yield on this type of investment. A one percentage point decline in mortgage interest rates makes only marginal improvements. Another proposal of Treasury I with same intention is the taxing of all partnerships with more than 35 partners as corporations, eliminating the passing thru of losses to the individual partners.

Finally, all three proposals would make other changes relevant to commercial real estate the effects of which are not presented in Table 8. These changes include the repeal of the investment tax credit, repeal of rehabilitation tax credits, repeal of Section 167K rules which allow rapid depreciation of rehabilitation expenses for low-income rental properties, and repeal of the tax exempt status of mortgage revenue bonds and industrial development bonds.

TABLE 7

COMPARISON OF TAX PROVISIONS IMPACTING COMMERCIAL REAL ESTATE UNDER ALTERNATIVE TAX REFORM PROPOSALS

	1986 Current Law	Bradley-Gephardt	Kemp-Kasten	Treasury I
Personal Marginal Tax Rates	14 rate brackets from 11% to 50%	3 rate brackets 14%, 26%, 30%	1 rate bracket 24%	3 rate brackets 15%, 25%, 35%
Personal Deductions				
Personal Interest other than mortgage interest.	Yes	Limited to passive investment income. 1/	No, except on education expenses.	Limited to $5,000, plus passive investment income. Amount above $5,000 indexed for inflation. 2/
Corporate Tax Rates	15 to 40 percent on first $100,000, 46 percent above $100,000.	30% flate rate	15% on first $50,000, 25% on next $50,000, 35% above $100,000.	33% flate rate
Depreciation	18 year life; 175% declining balance.	40 year life; 250% declining balance. 3/	25 year life; 6% of original basis per year, indexed for inflation.	3% of indexed, inflation adjusted basis. 63 year closeout.
Capital Gains				
Exclusion Basis indexed for inflation	60% No	0 No	Taxpayer option; 40% exclusion or indexed basis	0 Yes
Construction Period Interest And Taxes	10 year amortization allowed.	Unchanged	Unchanged	Repealed. Uniform capitalization rules would apply.
Interest Expense	Fully deductible	Fully deductible	Fully deductible	Indexed; partially nondeductible at positive inflation rates.
Investment Tax Credit	6% - 10%	Repealed	Repealed	Repealed

TABLE 7 (continued)

	1986 Current Law	Bradley-Gephardt	Kemp-Kasten	Treasury I
Rehabilitation Tax Credits	15% credit for 30 year old nonresidential structures; 20% credit for 40 year old nonresidential structures; 25% credit for historic residential and nonresidential structures.	Repealed	Repealed	Repealed
Section 167K Rules	Rehabilitation expenses for low income housing can be depreciated over 60 months.	Repealed	Repealed	Repealed
Installment Sales	Taxation deferred until payment received.	Unchanged	Unchanged	No deferral if receivables pledged as collateral.
"At Risk" Rules	Real estate exempt. Deductions may exceed the amount of equity plus recource financing.	Unchanged	Unchanged	"At risk" rule extended to real estate. Deductions limited to equity plus recourse financing.
Partnerships	"Pass-thru" of gains and losses to individual partners.	Unchanged	Unchanged	Partnerships with more than 35 members taxes as a corporation.
Mortgage Revenue Bonds	Interest is Tax Exempt	Interest Taxed	Interest Taxed	Interest Taxed
Industrial Development Bonds	Interest is Tax Exempt	Interest Taxed	Interest Taxed	Interest Taxed

Source: NATIONAL ASSOCIATION OF REALTORS®

1/ Under Bradley-Gephardt all personal deductions are deductible at the 14 percent marginal rate only.

2/ Under Treasury I mortgage interest on a secondary residence is included in this category.

3/ It is not known whether Bradley-Gephardt would allow component depreciation of a structure as was permitted prior to the Economic Recovery Tax Act of 1981.

TABLE 8

IMPACT OF TAX REFORM PROPOSALS ON A TYPICAL COMMERICAL REAL ESTATE INVESTMENT [1]
(PERCENT CHANGE FROM CURRENT LAW)

Case 1: Interest rates unchanged.

	1st Year Taxable Income	1st Year After-Tax Cash Flow	10-Year IRR [2]	10-Year NPV [3]	Long-Term Rents [4]	Impact on Investment
Treasury I						
A [5]	+118%	-122%	-39%	- 82%	+20%	-18%
B [6]	+187%	-174%	-62%	-147%	+32%	-29%
Bradley-Gephardt						
	+ 21%	- 57%	-25%	- 52%	+10%	-12%
Kemp-Kasten						
	+ 53%	- 83%	- 9%	- 1%	+ 4%	- 4%

Case 2: Interest rates fall by 1 percentage point upon adoption of the proposals.

	1st Year Taxable Income	1st Year After-Tax Cash Flow	10-Year IRR [2]	10-Year NPV [3]	Long-Term Rents [4]	Impact on Investment
Treasury I						
A [5]	+123%	-107%	-32%	- 62%	+16	-15%
B [6]	+187%	-155%	-53%	-121%	+27	-25%
Bradley-Gephardt						
	+ 30%	- 44%	-17%	- 34%	+ 7	- 8%
Kemp-Kasten						
	+ 62%	- 69%	- 2%	+ 18%	+ 1%	- 1%

Source: NATIONAL ASSOCIATION OF REALTORS®

TABLE 8 (continued)

1/ Assumptions underlying typical commercial real estate investment.

Basis: $1,000,000 project acquired 1/1/86 with original basis allocated $150,000 to land, $50,000 to furniture, fixtures & equipment, and $800,000 to real property.

Financing: $250,000 initial equity and 30-year conventional mortgage for $750,000 at 13.5% interest.

Income and Expenses: Net operating income of $100,000 increasing at 5% per year.

Projected Value: Starting Value of $1,000,000 increasing at 5% per year.

Expenses of Sale: Selling expenses of 6% upon ultimate sale.

Ownership: Individual taxpayer(s) in a marginal tax bracket of 50% under current law.

2/ Internal Rate of Return: the discount rate at which the present value of all future after-tax benefits equal the initial capital contribution.

3/ Net Present Value: The sum of all future after-tax benefits less initial capital contribution, discounted to 1/1/86 at 11% per annum.

4/ Long-Term Rent: The percentage amount that rents would have to change by, all else being equal, for 10-year IRR to be restored to the level under current law.

5/ Property used in a trade or business; all interest deductible subject to the indexing of indebtedness for inflation.

6/ Property held by a passive investor; interest deductions limited to $5,000.

Note: For purposes of indexing capital assets, adjusted basis, and interest indebtedness a 5 percent inflation rate was assumed.

Impact of Tax Reform on Interest Rates

If the United States were a closed economy so that there were no trade or capital flows with the rest of the world, it could be predicted with a high degree of certainty that the three tax reform proposals under discussion would cause market interest rates to fall from one to three percentage points. [6] However, the economic interdependence between the United States and the rest of the world is now very advanced and complex. For example, foreign investors now supply about 20 percent of the total supply of loanable funds in this country and are financing about 50 percent of the federal deficit.

The best available evidence suggests that this inflow of foreign funds is very responsive to the spread between U.S. interest rates and those available in other countries. If U.S. interest rates should decline due to lower marginal tax rates while the interest rates in other countries remained unchanged, the inflow of foreign funds into the U.S. would decline sharply, putting upward pressure on domestic interest rates. NAR was a co-sponsor of a study by Data Resources, Inc. (DRI), a major economic consulting firm, which examined this and other dynamic impacts of tax reform. The results of the DRI study suggest that due to the sharp reduction in inflow of foreign funds, interest rates would decline at most one percentage point under Treasury I and substantially less than that under Bradley-Gephardt and Kemp-Kasten.

Outlook for Treasury II

In the next few weeks the Treasury Department is expected to release the second version of it's tax reform proposal which is likely to be the Administration's proposal which is sent to Capitol Hill. Table 9 presents the best guess of the real estate related provisions likely to be included in Treasury II. Given the pro-capital formation posture of the current Treasury Secretary, we are likely to see several changes that will make the proposals more favorable toward savings, investment, and homeownership than Treasury I. However, the real test will be how it compares to current law with respect to those criteria.

TABLE 9

STATUS OF REAL ESTATE RELATED PROVISIONS IN TREASURY TAX REFORM PROPOSAL (BEST GUESS AS OF MAY 1, 1985)

Commerical, Industrial and Rental Residential	Current Law	Treasury I	Treasury II
Depreciation period	18 years	63 years	20-25 years
Rehabilitation tax credits	Yes	No	No
Capital Gains tax treatment	60% exclusion	No exclusion; asset indexed for inflation	60% exclusion for venture capital; Treasury I treatment for real estate.
Indexing of interest indebtedness	No	Yes	No
Tax partnerships with more than 35 partners as corporations	No	Yes	Limit raised, perhaps 100.
Extend "at risk" rules to real estate	No	Yes	Yes
Limit all non-principal residence interest deductibility to $5,000 plus net investment income, indexing the amount above $5,000 for inflation	No	Yes	Yes, but apply only to non-residences
Mortgage Revenue Bonds	Tax exempt, limits on volume	Taxed	Tax exempt, stricter limits on income
Industrial Revenue Bonds	Tax exempt, limits on volume	Taxed	Tax exempt, stricter limits on purpose and volume
Homeownership			
Property Tax Deductibility	Yes	No	No
Mortgage Interest Deductibility			
Primary residence	Unlimited	Unlimited	Unlimited
Secondary residence	Unlimited	Limited	Unlimited

Footnotes

1/ In this report the term commercial real estate refers to all depreciable real property, such as office, retail, industrial, and rental residential real estate. It does not include the special case of low-income rental residential properties.

2/ Under Kemp-Kasten, the marginal rate for determining the value of itemized deductions is 24 percent for all taxpayers. However, due to the mechanics of the 20 percent exclusion of employment income, the marginal tax rate on additional employment income is 19.2 percent up to the maximum taxable Social Security income, 28.8 percent on employment income between the Social Security maximum and two times the Social Security maximum, then falling back to 24 percent above two times the maximum Social Security income.

3/ These impact estimates pertain to a current buyer of such a property since it is the after-tax cost of a buyer that determines value.

4/ Before- and after-tax costs of homeownership and the change in home values are computed as follows:

a) First year mortgage interest equals the home value (V) times the loan-to-value ratio (LV) times the mortgage interest rate (r).

b) Property taxes are equal to V times the property tax rate (p).

c) Total before-tax cost (BTC) equals;

$$BTC = V(LV)(r) + V(p) = V(LV*r + p)$$

d) Tax savings (TS) equals the marginal tax rate (t) times all deductible expenses less the zero bracket amount (ZBA). Under current law, Bradley-Gephardt, and Kemp-Kasten;

$$TS = t[BTC - ZBA].$$

Under Treasury, since property taxes are not deductible;

$$TS = t[V(LV)(r) - ZBA].$$

e) After-tax cost (ATC) equals;

$$ATC = BTC - TS$$

f) To compute the change in home value, it is assumed that ATC remains constant across all tax regimes. Therefore, after computing ATC under current law, ATC is held constant, new values are used for t and ZBA, and then the expression is solved for V.

$$V = \frac{ATC - t* ZBA}{(LV*r + p) - t(LV*r + p)}$$

Footnotes (Continue)

In the case of Treasury I the expression is:

$$V = \frac{ATC - t^{*} ZBA}{(LV^{*}r + p) - t(LV^{*}r)}$$

5/ The Treasury I proposal introduces a radically different tax treatment of partnerships, where the individual gross incomes and expenses of the partnership are passed thru to the partners rather than just the net income of the partnership.

6/ The real after-tax rate of interest (RATr) is computed as follows:

$$r(1-t) - i = RATr$$

Where r is the nominal rate of interest, t is the marginal tax rate, and i is the expected inflation rate. If we assume that under current law $r = 13$, $t = .32$, and $i = 5$, then $RATr = 3.84$ $(13(1 - .32) - 5 = 3.84)$. The 32 percent marginal tax rate is the average for those taxpayers reporting interest income on their tax returns. If RATr and i are held constant and t is replaced with the comparable marginal personal tax rate under each of the tax reform proposals, r can then be solved for.

$$r = \frac{RATr + i}{1-t}$$

	Current Law	Bradley-Gephardt	Kemp-Kasten	Treasury I
Marginal Tax Rate	.32	.23	.22	.24
r	13	11.5	11.3	11.6

The Treasury I proposal would result in further reductions in interest rates since the interest indexing provision would result in only real interest income being taxed. In the case of Treasury I, the following formula for determing r would apply:

$$r = \frac{RATr}{1 - t} + i$$

Using this formula, r would decline to 10.1 percent.

Table 10

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,820	3,864	3,907	3,958	4,014	4,071	4,131	4,200	3,305	3,663	3,887	4,104	4,400
Percent Change	6.7	4.7	4.5	5.4	5.7	5.8	6.0	6.9	7.7	10.8	6.1	5.6	7.2
Percent Change (without inflation)	1.3	1.9	1.9	2.0	2.3	2.5	2.7	2.9	3.7	6.8	2.5	2.3	3.5
Consumption	4.7	3.2	2.0	2.3	2.5	2.5	2.7	2.8	4.8	5.3	3.4	2.5	3.2
Durables	6.9	4.4	1.5	2.1	2.0	2.1	3.2	3.7	12.1	13.1	5.6	2.4	4.8
Nondurables	4.2	3.2	2.3	2.2	2.6	2.4	2.2	2.4	3.7	4.6	2.4	2.4	2.7
Services	4.4	2.7	1.9	2.3	2.7	2.7	2.8	2.8	3.4	3.2	3.4	2.8	2.9
Residential Investment	-0.7	6.4	16.5	-3.9	-1.8	-0.6	-0.2	-0.2	41.7	12.2	1.1	0.8	0.4
Nonresidential Investment	3.4	5.1	3.8	4.3	3.7	3.4	4.3	5.5	2.5	19.8	7.0	4.0	6.6
Structures	16.2	6.0	1.3	0.8	0.6	0.3	1.9	4.1	-7.8	15.6	9.9	1.4	4.3
Equipment	-1.2	4.7	4.8	5.7	4.9	4.6	5.2	6.1	7.3	21.5	5.9	5.1	7.5
Exports	-8.2	4.9	4.5	6.8	6.9	7.9	8.1	8.1	-5.6	4.7	0.5	6.9	7.6
Imports	26.2	0.4	9.0	8.6	7.3	5.3	3.9	4.1	7.6	27.0	7.4	6.3	5.0
Government Purchases	0.1	5.1	2.9	2.1	8.0	1.2	1.4	1.8	-0.3	3.5	4.3	3.6	0.9
Consumption (% of GNP)	65.2	65.4	65.4	65.5	65.5	65.5	35.5	65.5	65.8	64.8	65.4	65.5	65.3
Residential Investment (% of GNP)	3.5	3.6	3.7	3.6	3.6	3.6	3.6	3.5	3.5	3.7	3.6	3.6	3.5
Nonresidential Investment (% of GNP)	12.9	13.0	13.1	13.2	13.2	13.2	13.3	13.4	11.1	12.5	13.1	13.3	13.7
Structures (% of GNP)	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.2	3.5	3.7	3.7	3.7
Equipment (% of GNP)	9.2	9.3	9.4	9.4	9.5	9.6	9.6	9.7	7.9	9.0	9.3	9.6	10.0
Inventory Change ($ billions)	46.6	26.5	21.4	21.5	10.2	11.0	9.3	6.6	-13.5	58.2	29.0	9.3	17.0
Mfg. Capacity Utilization Rate (%)	81	81	81	81	81	81	81	81	75	82	81	81	82
Auto Sales (millions of units)	10.8	10.6	10.7	10.7	10.4	10.3	10.5	10.5	9.2	10.4	10.7	10.4	10.8
Domestic (% of total)	78.0	76.9	73.4	72.2	73.0	72.5	69.8	68.0	74.0	76.5	75.1	70.9	68.1
Manufacturing Industrial Production (% change)	0.8	2.2	3.1	2.1	4.2	3.9	2.[illegible]	2.6	7.8	11.2	2.2	3.2	4.4
Common Market	1.6	2.0	2.8	2.1	1.4	3.2	1.4	2.6	0.9	3.2	2.2	2.1	1.5
Japan	0.7	2.0	4.0	5.6	11.6	3.0	0.7	1.8	3.5	11.0	4.8	5.2	1.0
Employment(millions)(civilian:household basis)	106.7	107.1	107.4	107.8	108.0	108.3	108.6	108.9	100.8	105.0	107.3	108.4	110.6
Percent Change	3.0	1.3	1.3	1.3	0.9	1.0	1.0	1.2	1.3	4.1	2.1	1.1	2.0
Unemployment Rate (%) (civilian)	7.3	7.5	7.6	7.7	7.8	7.9	8.0	8.0	9.6	7.5	7.5	7.9	7.8
Personal Income per Household (average)<1>	40,052	40,313	40,703	41,250	41,763	42,323	42,797	43,344	35,415	38,526	40,580	42,557	45,069
Percent Change -- Year Ago (w/o inflation)	3.5	2.0	1.4	1.2	1.0	1.6	1.7	1.5	1.5	5.4	2.0	1.5	2.1
Personal Taxes per Household (average)	7,741	7,370	7,705	7,821	7,925	8,050	8,155	8,284	6,478	6,956	7,659	8,104	8,599
Percent Change -- Year Ago (w/o inflation)	10.7	3.1	6.1	5.5	-0.6	5.9	2.5	2.4	-3.0	3.5	6.3	2.5	2.4
Percent of Personal Income	20.2	19.1	19.8	19.8	19.9	19.9	19.9	20.0	19.1	18.8	19.8	19.9	20.0
Disposable Income per Household (average)	32,311	32,943	32,998	33,429	33,838	34,273	34,641	35,060	28,938	31,571	32,920	34,453	36,471
Percent Change--Year Ago (w/o inflation)	2.0	1.9	0.6	0.5	1.6	0.8	1.6	1.4	2.5	5.7	1.2	1.3	2.1
Household Interest Payments (% of total)	10.4	10.5	10.9	10.9	10.8	10.8	10.8	10.3	9.8	10.4	10.7	10.7	9.6
Net Worth Per Household (average)	81,265	82,741	84,071	85,731	87,426	88,699	89,951	91,203	73,838	77,705	83,452	89,320	95,257
Percent Change--Year Ago (w/o inflation)	3.5	4.4	3.0	3.8	4.4	4.0	3.6	2.9	7.6	1.4	3.7	3.7	2.9
Consumer Price Inflation (CPI)	3.3	3.6	3.4	3.7	3.6	3.6	3.6	3.8	3.2	4.3	3.5	3.6	4.0
Gross National Product Inflation (GNP Deflator)	5.3	2.8	2.5	3.3	3.4	3.2	3.2	3.8	3.8	3.8	3.6	3.2	3.6
Personal Consumption Inflation	3.1	3.0	2.9	3.3	3.4	3.4	3.4	3.6	3.7	3.2	3.0	3.3	3.7
Residential Construction Inflation	5.1	2.5	3.2	3.1	3.6	3.7	3.6	3.7	1.7	3.9	3.8	3.4	4.0
Nonresidential Construction Inflation	1.2	1.6	2.7	3.3	3.5	3.5	3.5	3.7	-1.0	0.3	1.7	3.3	3.9
Producers Price Inflation (WPI)	-2.1	0.8	1.6	2.9	2.2	2.2	2.7	3.0	1.3	2.4	0.1	2.3	3.2
Compensation per Manhour (% change)	4.8	4.5	4.2	4.7	5.0	4.1	4.2	4.6	4.8	4.2	4.2	4.5	4.9
Productivity (% change)	-0.7	1.9	1.5	1.4	1.1	1.1	1.4	1.7	3.4	2.8	1.1	1.3	1.8
Unit Labor Cost (% change)	5.6	2.6	2.7	3.3	3.8	3.0	2.8	2.8	1.3	1.4	3.1	3.1	3.0
Unit Capital Cost (% change)	4.1	3.9	3.6	3.2	2.9	2.6	2.4	2.1	6.9	4.6	3.7	2.5	1.8
Before Tax Corporate Profits ($ billions)<2>	230	221	218	218	219	222	226	227	213	243	222	224	251
Corporate Tax Liability	91	84	82	81	84	85	86	87	86	98	84	85	98
After Tax Profits	139	137	137	137	136	137	140	141	127	146	137	138	153
Inventory Valuation Adjustment	-1	-2	-8	-12	-13	-12	-13	-15	-11	-6	-6	-13	-18
Capital Consumption Adjustment	71	77	82	88	90	93	95	97	33	56	79	94	92
Profits from Current Production (with IVA, CCA)	210	212	211	212	213	219	222	224	149	196	211	219	227
Adjusted for Inflation (84:3 base)	206	206	204	203	203	206	208	207	156	197	205	206	206
Percent Change - Year Ago	9.4	4.8	2.1	0.4	-1.5	0.0	1.8	2.0	46.0	26.5	4.1	0.6	-0.2
Per Unit of Output (% of GNP)	5.5	5.5	5.4	5.4	5.3	5.4	5.4	5.3	4.5	5.3	5.4	5.3	5.2
Effective Corporate Tax Rate (%)<2>	29	27	27	27	27	27	27	27	34	32	27	27	29
Federal Tax Receipts (Unified basis)	654	833	758	695	685	933	774	736	613	683	735	782	843
Percent of GNP	17.1	21.6	19.4	17.6	17.1	22.9	18.7	17.5	18.6	18.7	18.9	19.1	19.2
Federal Expenditures (Unified basis)	934	940	954	961	991	1,000	1,007	1,032	803	868	947	1,008	1,070
Percent of GNP	24.5	24.3	24.4	24.3	24.7	24.6	24.4	24.6	24.3	23.7	24.4	24.6	24.3
Surplus or Deficit (Unified basis)	-280	-107	-196	-265	-306	-67	-233	-296	-190	-184	-212	-225	-227
% of GNP	7.3	2.8	5.0	6.7	7.6	1.6	5.6	7.0	5.8	5.0	5.5	5.5	5.2
% of Personal Savings	231.6	76.6	164.9	212.1	240.0	50.9	180.7	231.1	158.1	117.2	171.3	175.7	162.9
% of Net Domestic Savings	92.6	33.5	66.5	89.0	103.0	21.9	76.4	97.2	80.0	56.5	70.4	74.6	71.3

<1> Includes personal contributions for social insurance.

<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 11

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	4,053	4,247	4,372	4,177	4,137	4,114	4,081	4,000	3,750	3,936	4,213	4,083	3,882
Percent Change -- Year Ago	-2.0	4.6	17.5	9.2	2.1	-3.1	-6.7	-4.3	42.4	5.0	7.0	-3.1	-4.9
Existing Single-Family Home Sales (thousands)	2,976	3,110	3,240	3,075	3,056	3,028	2,998	2,917	2,716	2,866	3,100	3,000	2,802
Percent Change - Year Ago	2.1	4.6	17.3	9.3	2.7	-2.6	-7.5	-5.2	36.5	5.5	8.2	-3.2	-6.6
Dollar Volume (billions)	261.8	276.3	287.9	266.9	271.1	273.6	272.6	259.6	224.2	247.1	273.2	269.2	260.4
Existing Home Prices - Median ($1000's)	73.9	75.4	76.0	74.6	76.7	78.4	79.1	77.6	69.8	72.3	75.0	77.9	81.3
Percent Change - Year Ago	3.7	3.7	3.8	3.7	3.7	3.9	4.1	4.0	3.2	3.5	3.7	3.9	4.4
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	642	644	639	633	655	674	685	677	633	665	639	673	720
Percent of Median Family Income	29	29	29	28	28	29	29	28	32	31	29	29	29
Private Housing Starts (thousands)	1,792	1,814	1,809	1,794	1,766	1,745	1,751	1,756	1,703	1,766	1,802	1,755	1,746
Percent Change - Year Ago	-8.0	-2.3	8.8	12.3	-1.4	-3.8	-3.2	-2.1	61.0	3.8	2.0	-2.7	-0.5
Single-Family	1,111	1,173	1,167	1,136	1,114	1,120	1,117	1,116	1,066	1,103	1,147	1,117	1,113
Percent of Total	62.0	64.7	64.5	63.3	63.1	64.2	63.8	63.6	62.6	62.4	63.6	63.7	63.8
Multi-Family	681	641	642	658	652	625	634	640	637	664	656	638	632
Percent of Total	38.0	35.3	35.5	36.7	36.9	35.8	36.2	36.4	37.4	37.6	36.4	36.3	36.2
Mobile Home Shipments	275	278	289	291	292	294	294	293	296	295	283	294	297
New Single-Family Home Sales (thousands)	646	659	630	615	617	612	588	559	627	637	637	594	555
Percent Change - Year Ago	-5.4	4.1	2.7	-0.4	-4.5	-7.0	-6.7	-9.1	49.9	1.5	0.1	-6.8	-6.6
New Home Prices - Median ($1000's)	83.1	83.8	84.7	85.6	86.6	87.6	88.6	89.7	75.5	80.0	84.3	88.1	92.6
Percent Change - Year Ago	6.6	4.1	4.1	6.6	4.2	4.5	4.6	4.7	8.9	6.0	5.4	4.5	5.1
New Home Prices--Mean ($1000's, Quality Adjusted)	96.2	96.4	97.9	98.5	99.2	99.7	101.3	102.1	89.7	93.7	97.3	100.6	104.6
Percent Change - Year Ago	5.7	3.2	2.9	3.5	3.1	3.4	3.5	3.7	2.1	4.5	3.8	3.4	4.0
NAR Affordability Index	88.3	86.0	85.8	87.9	85.9	84.7	85.2	89.3	82.0	86.2	87.0	86.3	89.5
New Mortgage Commitments ($ billions)	183.4	178.2	172.3	169.2	169.5	165.0	158.5	166.6	163.4	193.1	175.6	164.9	185.5
Percent Change - Year Ago	-4.1	-13.7	-3.7	-13.6	-7.6	-7.4	-8.0	-1.5	152.1	18.2	-9.0	-6.2	12.5
Mortgage Debt Outstanding ($ billions)	2,130	2,218	2,301	2,381	2,299	2,244	2,211	2,196	1,755	1,957	2,257	2,238	2,206
Homeowners' Equity ($ billions)<1>	1,465	1,473	1,490	1,511	1,535	1,563	1,593	1,626	1,553	1,503	1,485	1,579	1,700
Housing Inventory (millions)	92.0	92.4	92.8	93.1	93.5	93.9	94.3	94.6	89.6	91.1	92.6	94.1	95.5
Rental Vacancy Rate (%)	6.2	6.1	6.0	5.9	5.9	5.9	5.8	5.8	5.6	5.9	6.0	5.9	5.8
Unsold New Homes (% of sales)	55.4	54.6	56.2	59.4	62.5	62.5	60.6	57.6	42.9	50.7	56.4	60.8	58.1
Office Vacancy Rate (%)<2>	10.7	10.4	10.1	9.9	9.7	9.5	9.4	9.3	11.7	13.9	10.3	9.5	9.1
Industrial Vacancy Rate (%)<2>	4.0	3.9	3.8	3.8	3.7	3.7	3.6	3.6	4.9	4.7	3.9	3.6	3.4
New Commercial Building Construction (% Ch Value)	35.5	12.6	3.3	-0.1	-0.9	-3.1	-4.0	-0.7	-4.2	37.0	24.1	-0.2	2.0
New Industrial Building Construction (% Ch Value)	8.1	11.3	17.0	11.7	11.0	8.7	10.0	14.5	-25.7	11.6	12.7	11.5	14.0
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	10.8	6.3	4.7	4.9	5.3	4.9	5.3	5.7	11.2	6.9	6.3	5.2	5.2
M1 Velocity (% change)	-3.7	-1.4	-0.2	0.5	0.4	0.8	0.7	1.1	-3.2	3.7	-0.2	0.4	1.9
M2 (% change)(FED Target 6-9%)	12.7	8.3	5.1	5.6	5.9	6.7	6.4	6.2	12.5	7.9	8.7	6.1	6.4
M2 Velocity (% change)	-5.3	-3.3	-0.6	-0.2	-0.2	-0.9	-0.3	0.7	-4.4	2.7	-2.4	-0.5	0.7
Monetary Base (% change)	6.0	4.2	4.4	4.6	4.9	4.6	4.8	5.4	9.5	8.1	5.4	4.7	5.7
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	669	657	663	676	675	694	700	703	479	653	666	693	748
Private													
Personal Savings	121	139	119	125	128	132	129	128	118	156	126	129	138
Savings Rate	4.6	5.1	4.4	4.5	4.5	4.6	4.5	4.4	5.0	6.1	4.7	4.5	4.5
Gross Business Savings	547	554	557	562	569	580	588	596	454	519	555	583	617
Government													
Federal	-165	-198	-182	-188	-197	-199	-202	-208	-179	-176	-183	-201	-205
State and Local	56	54	52	51	49	50	51	53	44	53	53	51	58
Foreign (current account deficit)	109	108	118	125	127	131	133	135	42	102	115	131	141
Uses (total:gross investment)	657	648	656	664	660	670	678	688	472	638	656	674	739
Nonresidential Investment													
Equipment	291	296	300	306	311	317	324	331	223	275	298	321	357
Structures	164	168	169	171	173	174	177	180	130	150	168	176	191
Residential Investment	155	158	166	165	166	167	168	170	132	154	161	168	175
Inventory Investment	47	27	21	22	10	11	9	7	-13	58	29	9	17
Value of the U.S. Dollar (Weighted by Trade) (Base=1967)	1.200	1.149	1.127	1.119	1.099	1.081	1.066	1.052	1.024	1.095	1.149	1.074	1.017
Percent Change	21.5	-15.9	-7.5	-2.7	-7.2	-6.1	-5.4	-5.4	3.7	6.9	4.9	-6.5	-5.4
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	13.3	13.1	12.9	13.0	13.1	13.2	13.3	13.4	13.9	14.2	13.1	13.3	13.6
Real Mortgage Rate (30 yr. avg. is 4.5%)	8.1	10.3	10.4	9.7	9.7	10.0	10.1	9.6	10.2	10.5	9.6	9.8	9.8
1 Year ARM (without buy-down)	11.1	10.6	10.6	10.6	10.8	10.9	10.9	10.9	11.3	12.6	10.7	10.9	11.3
Real Mortgage Rate	5.8	7.8	8.0	7.3	7.4	7.8	7.7	7.0	7.5	9.0	7.2	7.5	7.5
Corporate Bond Rate (AAA)	12.3	12.1	12.0	12.1	12.2	12.3	12.3	12.4	12.0	12.7	12.1	12.3	12.6
Government Bond Rate	11.8	11.6	11.5	11.6	11.7	11.8	11.8	11.9	11.3	12.5	11.6	11.8	12.1
Real Government Bond Rate (30 yr. avg. is 2.1%)	6.5	8.8	9.0	8.3	8.3	8.6	8.6	8.1	7.6	8.9	8.1	8.4	8.3
Federal Funds Rate	8.5	8.2	8.5	8.7	8.8	9.1	9.2	9.3	9.1	10.2	8.5	9.1	9.9
3 Month Treasury Bill Rate	8.2	7.8	7.8	7.9	8.0	8.2	8.3	8.3	8.6	9.5	7.9	8.2	8.8
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	2.9	5.0	5.3	4.6	4.6	5.1	5.1	4.5	4.8	5.9	4.4	4.8	5.0
1 Year Treasury Bill Rate	9.4	8.9	8.9	8.9	9.1	9.2	9.2	9.2	9.6	10.9	9.0	9.2	9.6
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	4.1	6.1	6.3	5.6	5.7	6.1	6.0	5.3	5.8	7.3	5.5	5.8	5.8
Commercial Paper Rate	8.5	8.2	8.4	8.5	8.6	8.9	9.0	9.1	8.9	10.1	8.4	8.9	9.6
Rate on Money Market Fund Shares	8.6	8.3	8.5	8.7	8.8	9.1	9.2	9.2	9.0	10.3	8.5	9.0	9.8
Prime Rate	10.5	10.4	10.4	10.8	10.9	11.1	11.1	11.1	10.8	12.0	10.5	11.1	11.7

<1> Homeowners Equity has been adjusted to correspond to the Federal Reserve's Flow of Funds data.
<2> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

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Outlook for the Economy and Real Estate

Aggregate Economy

It has become quite apparent that economic activity has begun to dampen. The downward revision in first quarter real GNP growth to 0.7 percent marks the smallest growth rate since the expansion began in late 1982. Contributing to the large slowdown in real economic activity was a further deterioration in the trade deficit as growth in imports exceeded growth in exports. Furthermore, the slower pace in final domestic sales also led to lower growth, reflecting the slowing in consumer spending and borrowing; both had been intensified by the absence of tax refunds. A modest rebound in economic activity is expected during the second quarter as the IRS tries to meet its June 1 deadline. This will provide a small boost to consumption. However, once the windfall gains from tax refunds wears off economic activity should continue slowing.

Underlying the weakening in economic activity through 1985 will be the mounting debt burdens by the U.S., consumers and businesses. The sharp deterioration in the debt position of the U.S. relative to other countries shows no sign of improvement. The trade deficit deteriorated further in April, recording the largest monthly increase for all of 1985. Domestic businesses have been unable to trade competitively not only in domestic markets but international markets as well because the dollar has been so strong relative to other currency. Therefore, since the U.S. continues to buy more foreign goods and services then they are able to sell, they must borrow in order to finance this trade deficit. The result has been an undesirable accumulation of inventories and slowing production in the U.S., leading to enormous drains on real economic activity.

The increased reliance by both consumers and businesses on credit threatens the strength of economic activity in the near term. It was originally this strong demand by both consumers and business that stimulated the recovery. Yet, because spending growth has exceeded income gains over the past year, consumers had to borrow or deplete their savings to accomodate their spending. As a result of the high debt burdens now being sustained by both groups and the possibility of a further slowing in personal income as well as corporate profits, consumers and businesses are not likely to launch another spending spree like 1984. Rather, consumer and business spending is likely to remain at a modest pace through the remainder of this year as they attempt to reduce their debt burdens. This will continue to dampen output growth through 1985. For all of 1985, output growth should be 2 to 2 1/2 percent compared to an average of 5.2 percent during the previous two years.

However, with this slower growth the resulting decline in demand for funds for investment will allow interest rates to decline and remain at low levels. This should result in improvement in the interest-sensitive sectors, especially housing, and prevent the economy from experiencing a recession. Auto sales, after recording strong gains during the first half of May due to "cut rate" financing incentives, had begun to falter by months end, and are not expected to record as strong gains as previously expected. Therefore, the housing industry is expected to provide the stimulus to prevent a recession or too-slow growth while other sectors of the economy are expected to remain sluggish. Growth of overall economic activity should improve modestly in 1986 followed by more rapid output growth in 1987.

Employment and Inflation

The outlook for inflation remains favorable. The modest 0.4 percent increase in the Consumer Price Index (CPI) in April occurred in response to recent increases in energy prices from their previously low levels. Further, the Producer Price Index (PPI) for final goods, after remaining virtually unchanged from December to February, increased a modest 0.3 percent in April resulting in a total increase during the past 12 months of only 0.7 percent. This trend is expected to continue and inflation, as measured by the CPI, is expected to increase a modest 3.6 percent for 1985 before accelerating slightly in 1986.

Nonfarm payroll employment increased 0.3 percent from April to May. The entire increase was attributable to an increase in employment in the service sector, while employment in the good-producing sector remained stagnant. In fact, because employment actually declined in the manufacturing sector, the only reason employment in the goods producing sector didn't decline was the offsetting increase in construction employment that accompanied it. Employment growth has not increased sufficiently to satisfy all new entrants into the labor force, which typically swells at this time of year as high school and college students seek summer jobs. Subsequently, the civilian unemployment rate has remained unchanged over the past three months, further underscoring the slowing in the economy.

Monetary Policy and Interest Rates

In view of mounting evidence that the economy had slowed significantly, in March the Federal Open Market Committee of the Federal Reserve Board (FED) voted to ease credit conditions in an effort to lower interest rates and spin the economy. As shown in Table 1 both short-term and long-term interest rates have fallen nearly 1 1/2 percentage points since then, although mortgage rates have declined more slowly. The decline in market rates prompted the FED to reduce its discount rate from 8 percent to 7 1/2 percent on May 20 which provided additional optimism to credit markets.

M1, the nation's basic money supply, has been increasing rapidly since April in response to this easing by the FED. However, given the relatively low level of capacity utilization in the economy and the below-normal growth of the velocity of money, the FED appears to be appropriately unconcerned with the rapid growth of M2. In fact, given the continued weakness in the economy during the second quarter it is very likely that interest rates will continue to trend downward in the weeks ahead as credit markets anticipate further easing of credit conditions by the FED with another cut in the discount rate to 7 percent. This edging down of interest rates should continue through the third quarter. However, as the economy responds to these lower rates in the fourth quarter of this year, short-term rates should start to trend upward. Long-term rates should continue their downward trend well into 1986 as investors grow more confident that inflation remains under control.

Table 1

Selected Interest Rate

	Treasury Bills			AAA Corporate Bonds	Mortgage Commitment Rate	
	3 Months	6 Months	1 Year		Fixed Rate	Adjustable Rate
Jan	7.74	8.04	8.34	12.13	13.66	11.83
Feb	8.12	8.20	8.44	12.0	13.45	11.59
March	8.50	8.84	9.01	12.5	13.77	11.54
April	7.97	8.31	8.47	12.24	13.81	11.65
May	7.50	7.75	7.89	11.74	13.51	11.34
Week ended June 7	6.97	7.16	7.22	11.02	NA	NA

NA - Not available

Fiscal Policy

Despite the continuing efforts of Congress and the Administration to implement $50 billion in budget cuts next year, the deficit should increase in 1986 to $220 billion before declining to $210 billion in 1987. However, the deficit as a percent of GNP and net domestic savings should decline into 1986 and 1987.

The introduction of Reagan's tax reform proposal could lead to increases in the deficit over the next few years. This would occur because the proposed cuts in spending would not offset the tax cut due to the absence of revenue neutrality. Under the Reagan tax proposal, deficits could increase by as much as $50 billion over the next 3 years.

Real Estate Markets

The one bright spot in the economy has been the rebound in the housing market. Lower mortgage interest rates, accompanied by the strong demand for housing, boosted the seasonally adjusted annual rate of existing single family home sales to 3.04 million units in April, comparable to the March revised rate of 3.03 million units. This improvement in resales is expected to continue through this year with 3.1 million existing single family homes expected to be sold for all of 1985, making 1985 the best year for home resales volume since 1979. As mortgage commitment rates remain near 12 percent in 1986, existing home sales should continue to improve with resales reaching 3.15 million units for all of 1986.

Because builders often buy large blocks of below market financing, new home sales have not been as responsive as existing home sales to recent declines in mortgage interest rates. However, the demand for new homes is far from weak with the seasonally adjusted annual rate of new single family home sales at 612,000 in April, the fifth conseceutive month it has been above the 600,000 level. New home sales are expected to reach 644,000 for all of 1985.

Housing starts improved a modest 1.6 percent from March to April. The increase occurred almost entirely in the multi-family sector. The volatility of multifamily starts since January has occurred mainly in response to fear about anti-housing provision of the second Treasury Tax proposal, which could, among other things, adversely affect rental housing completed later this year. For all of 1985, total housing starts are expected to total 1.85 million units. By 1986, housing starts should reach 1.8 million units before declining slightly into 1987.

The recent declines in mortgage interest rates accompanied by only modest increases in home prices has been improving affordability and enabling an increasing number of families the chance to own a home. The NAR Housing Affordability Index for resale homes rose to 90.3 in April, the first time in more then 5 years that the index has been in the 90's. Affordability is expected to continue to improve through 1985 as mortgage interest rates continue to edge downward.

The outlook for nonresidential construction remains mixed. Office building occupancy rates will improve during the next few years but slow enough to result in a decline in construction through 1986. In addition, as slow economic activity dominates, industrial construction is expected to show only modest gains in 1985 and 1986.

Construction of stores and other commercial space, unlike the other areas of nonresidential construction, are expected to remain strong. This will occur in response to the strong activity in residential investment as new developments will need support services through retail and commercial space.

Table 2

Commercial and Industrial Building Contracts

	Stores and Other Commercial		Office Buildings		Industrial Buildings	
Year	millions of sq ft	percent change	millions of sq ft	percent change	millions of sq ft	percent change
1981	337	-11%	325	+15%	187	-13%
1982	245	-27%	261	-20%	118	-37%
1983	362	+48%	281	+ 8%	107	-37%
1984	477	+32%	317	+13%	143	+33%
1985^f	496	+ 4%	275	-13%	150	+ 5%
1986^f	486	- 2%	265	- 4%	160	+ 7%

f: forecast

Source: Historical Data: DRI, Review of the U.S. Economy, December 1984.
Forecasts: NATIONAL ASSOCIATION OF REALTORS®

Special Supplement

The Impact of the Reagan Tax Reform Proposal

President Reagan has introduced his tax reform proposal for "Fairness, Growth, and Simplicity" and sent it to the Congress. Our analysis of the proposal reveals that it would have much the same impact as the Treasury's proposal introduced last November: a cut in personal taxes financed through an increase in taxes on income generated by capital. As a result, there is a shift in the composition of GNP toward consumption and away from investment. In the long-run the effect of the lower level of investment compounds and results in a lower level of GNP and lower living standards for the average person and family.

Long-lived assets such as real estate would be particularly hard hit by this proposed change in the tax code. The loss of property tax deductibility and the lowering of marginal personal tax rates would increase the after-tax cost of owner-occupied homes, resulting in a decline in both existing home sales and starts of new homes. The yield on investments in commercial real estate would decline due to less adequate depreciation, restrictions on mortgage interest deductibility by some types of real estate investors, and numerous other proposed changes in tax law.

Further, analysis reveals that it is very unlikely that these negative impacts on real estate would be offset by a decline in interest rates, as was argued with Treasury I. The increase in taxes on income from capital reduces the supply of loanable funds in the economy to a far greater extent than that supply is increased through the reduction in personal taxes. The net impact is a decline in the supply of loanable funds which more than offsets the effect of lower marginal tax rates. In addition, the Reagan proposal includes several overly optimistic assumptions about the revenue provided by the new tax system. With more realistic assumptions it is likely that the package would not be revenue neutral, adding as much as $50 billion to the federal deficit within three years. Thus, it is quite likely that this proposal will result in higher interest rates which would further reduce capital formation.

Owner-Occupied Homes

Table 3 presents a comparison of the provisions of current tax law which impact the after-tax cost of homeownership with Treasury I and the Reagan proposal. Current law is expressed as it is believed it will be in 1986 when the zero bracket amount (ZBA) or standard deduction, exemptions, and tax brackets are indexed for inflation.

The Reagan proposal would raise the taxpayer and spouse exemption as well as the dependent exemption. Increasing the value of exemptions tends to raise after-tax homeownership costs since, for a given level of gross income, larger exemptions result in lower taxable income and so are likely to result in a lower marginal tax rate.

Table 3

Comparison of Tax Provisions Impacting After-Tax Homeownership Costs Under Current Law, Treasury I, and Reagan Proposal

	1986 Current Law	Treasury I	Reagan Proposal
PERSONAL MARGINAL TAX RATES	14 rate brackets from 11 to 50%	3 rate brackets 15%, 25%, 35%	3 rate brackets 15%, 25%, 35%
EXEMPTIONS			
Self, spouse	$1,080	$2,000	$2,000
Dependents	$1,080	$2,000	$2,000
Elderly	$1,080	Credit	Credit
Blind	$1,080	Credit	Credit
ZERO BRACKET AMOUNTS			
Single	$2,480	$2,800	$2,900
Joint	$3,670	$3,800	$4,000
Heads of Household	$2,480	$3,500	$3,600
INDEXED RATE BRACKETS, EXEMPTIONS, AND ZBA	Yes	Yes	Yes
PERSONAL DEDUCTIONS			
Mortgage Interest			
Principle Residence	Yes	Yes	Yes
Secondary Residence	Yes	Treated as other personal interest.	Treated as other personal interest.
Other personal interest	Yes Investment interest limited to $10,000 over investment income.	Limited to $5,000 plus passive investment income. (Expanded definition of interest subject to limit) Amount above $5,000 indexed for inflation.	Limited to $5,000 plus passive investment income. (Expanded definition of interest subject to limit)
Real Property Taxes	Yes	No	No
State and Local Income Taxes	Yes	No	No
Medical Expenses	Yes, above 5% of AGI	Yes, above 5% of AGI	Yes, above 5% of AGI

Table 3 (continued)

	1986 Current Law	Treasury I	Reagan Proposal
Charitable Contributions	Yes, for itemizers and nonitemizers.	Yes, above 2% of AGI. But no deduction for unrealized gains on contributed property. Also, no deduction for nonitemizers.	Deductible for itemizes but not for nonitemizers.
Two-Earner Deduction	Yes, 10% of lower salary	No	No
FRINGE BENEFITS			
Health Insurance	Not taxed	Annual premiums over $840 for individual coverage and over $2,100 for family coverage taxed.	First $120 of premiums per year for individual coverage and and $300 for family coverage taxed.
Group-term life insurance	Premiums for insurance over $50,000 taxed.	Taxed	Premiums for insurance over $50,000 taxed.
Other	Not taxed	Taxed	Not taxed
OTHER INDIVIDUAL ITEMS			
Rollover of Capital Gains on Principal Residence	Capital gain tax deferred if seller purchases another residence costing at least as much as the one sold within two years.	Yes	Yes
One-time Exclusion on Capital Gains on Principal Residence	One-time exclusion of gain up to $125,000 on sale of principal residence for taxpayers 55 or older.	Yes, plus exclusion is indexed for inflation.	Same as current law.
MUNICIPAL BONDS			
Public purpose	Tax-exempt	Tax-exempt	Tax-exempt
Private purpose	Tax-exempt	Taxed	Taxed

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

The Reagan tax reform proposal also raises the ZBA to $4,000 for a joint return, a slightly larger increase than was proposed in Treasury I. Increasing the ZBA also reduces the value of a given dollar amount of itemized deductions since it is the amount of such deductions above the ZBA by which taxable income is reduced.

The mortgage interest deduction is retained for principal residences but other personal interest deductions are limited to $5,000 plus the amount of passive investment income. Other personal interest includes consumer interest, mortgage interest on a second home, interest on loans to purchase stocks, bonds, land, etc., and a limited partner's pro-rata share of the interest expense of a limited partnership. Investment income includes income from assets such as stocks and bonds. The deductibility of all state and local taxes, including real property taxes, are also repealed.

The existing rollover of capital gains on the sale of a principal residence is retained as well as the one-time exclusion of capital gains up to $125,000 on the sale of a principal residence by taxpayers 55 or older.

Due to both the loss of property tax deductibility and the diminished tax savings provided by the mortgage interest deduction, which results from lower marginal tax rates and the increased ZBA, the after-tax cost of ownership of a principal residence would rise under the Reagan proposal. Table 4 presents estimates of the magnitude of this increase in annual after-tax cost for three home prices - $50,000, $85,000 and $150,000. Based on a typical minimum income required to qualify for mortgage loan to purchase such a home, the annual after-tax cost of a $50,000 home would increase about $225 or four percent. The impact on higher priced homes is more severe due to the larger decline in marginal tax rates for the typical buyers of these homes. The annual after-tax cost of an $85,000 home would rise by about $950 or 10 1/2 percent while the after-tax cost of a $150,000 would rise by about $2,500 or 19 percent.

Table 5 presents the contribution of the loss of property tax deductibility to the increase in after-tax cost of an $85,000 home. There are two distinct ways to evaluate this contribution, to assume that under current law property taxes would no longer be deductible or to assume that property taxes would be deductible under the Reagan proposal. In the former case (Case I), the loss of property tax deductibility contributes $372 or 40 percent of the total increase in after-tax cost while in the latter case (Case II) it contributes $255 or 27 percent of that increase.

Commercial Real Estate

Table 6 presents the impact of the Reagan proposal on a typical commercial real estate investment assuming interest rates remain unchanged. Under the Reagan proposal, the impacts will vary depending on the legal form of ownership, whether it is a sole proprietor or general or limited partners. In general, the Reagan proposal will most adversely affect the limited partnership because they are more limited in their ability to deduct interest.

Table 4

Comparison of After-Tax Homeownership Costs Under Current Law, Treasury I and the Reagan Tax Reform Proposals 1/ (Mortgage Rates Unchanged)

EXAMPLE #1

Cost of Home - $50,000
Required Income - $21,500

	1986 Current Law	Treasury I	Reagan Proposal
Before Tax Cost ($)	$6,200	$6,200	$6,200
Marginal Tax Rate (%)	16%	15%	15%
Tax Savings ($)	405	210	180
After Tax Cost ($)	5,795	5,990	6,020
Change in Cost ($)	- -	195	225
Change in Cost (%)	- -	3.4%	3.9%
Change in Home Value (%)	- -	-3.6%	-4.2%

EXAMPLE #2

Cost of Home - $85,000
Required Income - $36,000

	1986 Current Law	Treasury I	Reagan Proposal
Before Tax Cost ($)	$10,540	$10,540	$10,540
Marginal Tax Rate (%)	25%	15%	15%
Tax Savings ($)	1,664	756	726
After Tax Cost ($)	8,876	9,784	9,814
Change in Cost ($)	- -	908	938
Change in Cost (%)	- -	10.2%	10.6%
Change in Home Value (%)	- -	-9.9%	-10.2%

EXAMPLE #3

Cost of Home - $150,000
Required Income - $ 64,000

	1986 Current Law	Treasury I	Reagan Proposal
Before Tax Cost ($)	$18,600	$18,600	$18,600
Marginal Tax Rate (%)	38%	25%	25%
Tax Savings ($)	5,431	2,950	2,900
After Tax Cost ($)	13,169	15,650	15,700
Change in Cost ($)	- -	2,481	2,531
Change in Cost (%)	- -	18.8%	19.2%
Change in Home Value (%)	- -	-16.9%	-17.2%

1/ All examples assume a 20 percent downpayment, a 30 year fixed rate mortgage with a 13 percent interest rate, and property taxes equal to 2 percent of the home value. Required income assumes 25 percent of income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

The first case is for property owned by a sole proprietor or general partners. In this case, the 10 year Internal Rate of Return (IRR) would decline from 18.6 percent under current law to 16.8 percent under the Reagan proposal. This would result in a 14 percent decline in the properties value in the short-run. Therefore, long-term rents would have to increase by 8 percent in order for the 10 year internal rate of return to be restored to the level under current law.

The second case assumes limited partners having full use of the cap on other personal interest of $5,000 plus net investment income. In this example, the 10 year internal rate of return would decline to 14.9 percent, again this compares to 18.6 percent under current law. The result would be a 16 percent decline in the value of property. Long-term rents would, therefore, have to increase 10 percent in order for the IRR to be restored to the level under current law.

Those hardest hit by the Reagan proposal will be limited partners who have exhausted their ability to deduct other personal interest so no interest can be deducted. In this case the 10 year IRR will decline dramatically from current law of 18.6 percent to 7.8 percent. In the short-run, property values would decline by as much as 38 percent until rents are increased. In the long-run rents would have to increase 31 percent in order to restore the 10 IRR received under current law.

Macroeconomic Impacts

Table 7 provides the preliminary results of our macroeconomic simulation of the full Reagan proposal. These results indicate that total fixed capital formation would decline, leading to slower growth of GNP. Interest rates increase slightly in the short-run due to a net decline in loanable funds but then rise substantially in the long-run due to the added impact of an expanding deficit.

Table 5

Determination of the Impact of the Loss of Property Tax Deductibility on the After-Tax Cost and Value of an $85,000 Owner-Occupied Home

Case I

	1986 Current Law	1986 Current Law Without Property Tax Deduction	Reagan Proposal	Loss of Property Tax Deductibility as a Percent of Total Impact
Before Tax Cost ($)	$10,540	$10,540	$10,540	
Tax Savings ($)	1,664	1,292	726	
After Tax Cost ($)	8,876	9,248	9,814	
Change in Cost ($)	--	372	938	40%
Change in Cost (%)	--	4.2%	10.6%	
Change in Value ($)	--	-3,791	-8,653	44%
Change in Value (%)	--	-4.5%	-10.2%	

Case II

	1986 Current Law	Reagan Proposal with Property Tax Deduction	Reagan Proposal	Loss of Property Tax Deductibility as a Percent of Total Impact
Before Tax Cost ($)	$10,540	$10,540	$10,540	
Tax Savings ($)	1,664	981	726	
After Tax Cost ($)	8,876	9,559	9,814	
Change in Cost ($)	--	683	938	27%
Change in Cost (%)	--	7.7%	10.6%	
Change in Value ($)	--	-6,480	-8,653	25%
Change in Value (%)	--	-7.6%	-10.2%	

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

Table 6

Impact of Treasury I and Reagan Proposal on a Typical Commercial Real Estate Investment 1/ (Mortgage Rates Unchanged)

Description	1st Year Taxable Income	1st Year After-Tax Cash Flow	10-Year IRR 2/	10-Year NPV 3/	Long-Term Rents 4/	Change in Value 5/
Treasury I						
Case A	+118%	-122%	-39%	- 82%	20%	-28%
Case B	---	---	---	---	---	---
Case C	+187%	-174%	-62%	-147%	32%	-39%
Reagan Proposal						
Case A	+ 45%	- 67%	-17%	- 27%	8%	-14%
Case B	+ 94%	-104%	-26%	- 48%	10%	-16%
Case C	+171%	-162%	-61%	-144%	31%	-38%

Case A: Property owned by sole proprietor or general partners.

Case B: Limited partners having full use of the cap on other personal interest of $5,000 plus net investment income, here interpreted as their pro-rata share of net operating income less depreciation.

Case C: Limited partners who have exhausted their ability to deduct other personal interest so no interest can be deducted.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Table 6 (Continued)

1/ Assumptions underlying typical commercial real estate investment.

Basis: $1,000,000 project acquired 1/1/86 with original basis allocated $150,000 to land, $50,000 to furniture, fixtures & equipment, and $800,000 to real property.

Financing: $250,000 initial equity and 30-year conventional mortgage for $750,000 at 13.5% interest.

Income and Expenses: Net operating income of $100,000 increasing at 5% per year.

Current Law Depreciation: 18 years ACRS for real property, 5 years ACRS for personal property.

Projected Value: Starting Value of $1,000,000 increasing at 5% per year.

Expenses of Sale: Selling expenses of 6% upon ultimate sale.

Ownership: Individual taxpayer(s) in a marginal tax bracket of 50% under current law.

2/ Internal Rate of Return: the discount rate at which the present value of all future after-tax benefits equal the initial capital contribution.

3/ Net Present Value: The sum of all future after-tax benefits less initial capital contribution, discounted to 1/1/86 at 11% per annum.

4/ Long-Term Rent: The percentage amount that rents would have to change by, all else being equal, for 10-year IRR to be restored to the level under current law.

5/ Change in Value: The percentage change in the value of the property that would likely occur in the short-run prior to changes in rents.

Note: For purposes of indexing capital assets, adjusted basis, and interest indebtedness a 5 percent inflation rate was assumed.

Table 7

Preliminary Macroeconomic Impacts of the Reagan Tax Reform Proposal
(% Change from Baseline Except where Otherwise Noted)

	1986	1987	1988	1989	1990	1995
Real GNP	0.2	- 0.1	- 0.3	- 0.7	- 1.0	- 2.0
Employment	0.1	0.0	- 0.1	- 0.2	- 0.4	- 1.0
Inflation (% point change)	0.0	0.0	0.0	- 0.1	- 0.1	- 0.1
Real Consumption	0.5	0.5	0.3	0.2	0.0	- 0.2
Real Fixed Investment	- 0.7	- 2.0	- 2.7	- 3.0	- 2.8	- 3.1
Residential	- 3.0	- 5.0	- 7.0	- 8.0	- 8.0	- 8.0
Nonresidential	0.0	- 1.2	- 1.5	- 1.6	- 1.3	- 1.7
Equipment	0.3	- 1.5	- 1.9	- 1.9	- 1.4	- 1.8
Structures	- 0.2	- 0.4	- 0.6	- 0.8	- 1.0	- 1.5
Housing Starts	- 6.2	- 8.0	- 8.0	- 7.9	- 7.5	- 7.2
Single Family	- 5.2	- 5.7	- 6.0	- 5.9	- 5.5	- 5.2
Multi-Family	- 8.0	- 8.5	- 9.0	- 8.9	- 8.5	- 8.0
Existing Home Sales	- 8.0	- 9.0	- 8.5	- 8.0	- 7.5	- 7.0
Value of the Stock of Single Family Homes	-10.0	-10.2	-10.7	-11.2	-11.5	-10.5
Effective Mortgage Rate (% point change)	0.28	0.34	0.30	0.36	0.40	0.85
Aaa Bond Rate (% point change)	0.27	0.29	0.28	0.33	0.35	0.77
3 Month T-Bill Rate (% point change)	0.25	0.26	0.30	0.28	0.40	1.00
Rental Cost of Capital						
Structures	2.4	2.5	2.4	2.3	2.2	2.0
Equipment	10.2	8.2	7.9	7.9	7.8	7.8
Federal Deficit	3.0	5.0	8.0	10.0	12.0	24.0
Federal Revenues	- 0.8	- 1.3	- 2.0	- 2.5	- 3.0	- 6.0
Personal Tax (% of total)	- 6.1	- 6.1	- 5.9	- 4.3	- 3.5	- 3.3
Corporate Tax (% of total)	38.2	24.7	26.2	23.8	25.7	1.6

Table 7

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	4,058	4,158	4,290	4,374	4,386	4,376	4,297	4,101	3,750	3,936	4,220	4,290	4,041
Percent Change -- Year Ago	-1.9	2.4	15.2	14.3	8.1	5.3	0.2	-6.2	42.4	5.0	7.2	1.7	-5.8
Existing Single-Family Home Sales (thousands)	2,970	3,106	3,140	3,190	3,235	3,200	3,150	3,015	2,716	2,866	3,100	3,150	2,950
Percent Change - Year Ago	1.9	4.5	13.6	13.4	8.9	3.0	0.3	-5.5	36.5	5.5	8.2	1.6	-6.4
Dollar Volume (billions)	261.3	276.4	279.2	277.0	286.8	289.4	286.4	268.4	224.2	247.1	273.5	282.7	273.9
Existing Home Prices - Median ($1000's)	73.8	75.5	76.0	74.6	76.6	78.4	79.1	77.6	69.8	72.3	75.0	77.9	81.3
Percent Change - Year Ago	3.6	3.8	3.8	3.7	3.7	3.9	4.1	4.0	3.2	3.5	3.7	3.9	4.3
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	641	640	611	587	597	616	622	610	633	665	620	611	669
Percent of Median Family Income	29	29	27	26	26	26	26	25	32	31	28	26	27
Private Housing Starts (thousands)	1,793	1,815	1,887	1,910	1,809	1,840	1,807	1,745	1,703	1,766	1,851	1,800	1,755
Percent Change - Year Ago	-7.9	-2.3	13.5	19.5	0.9	1.4	-4.2	-8.6	61.0	3.8	4.8	-2.8	-2.5
Single-Family	1,122	1,084	1,185	1,220	1,186	1,212	1,183	1,119	1,066	1,103	1,153	1,175	1,124
Percent of Total	62.6	59.7	62.8	63.9	65.6	65.9	65.5	64.1	62.6	62.4	62.3	65.3	64.1
Multi-Family	671	731	702	689	623	628	624	626	637	664	698	625	631
Percent of Total	37.4	40.3	37.2	36.1	34.4	34.1	34.5	35.9	37.4	37.6	37.7	34.7	35.9
Mobile Home Shipments	277	292	300	297	283	288	285	282	296	295	291	284	289
New Single-Family Home Sales (thousands)	654	630	642	659	648	633	606	561	627	637	646	612	505
Percent Change - Year Ago	-4.2	-0.4	4.6	6.8	-0.8	0.4	-5.6	-14.9	49.9	1.5	1.5	-5.3	-17.5
New Home Prices - Median ($1000's)	83.1	83.9	84.8	85.7	86.8	88.1	89.3	90.7	75.5	80.0	84.4	88.7	93.9
Percent Change - Year Ago	6.6	4.2	4.3	6.7	4.5	5.0	5.4	5.8	8.9	6.0	5.4	5.2	5.8
New Home Prices--Mean ($1000's, Quality Adjusted)	96.2	96.3	97.8	98.5	99.5	100.1	102.0	103.1	89.7	93.7	97.2	101.2	106.0
Percent Change - Year Ago	5.7	3.1	2.8	3.4	3.4	3.9	4.3	4.7	2.1	4.5	3.8	4.1	4.7
NAR Affordability Index	88.4	89.1	90.8	95.0	93.5	93.0	94.7	98.7	82.0	86.2	90.8	95.0	95.0
New Mortgage Commitments ($ billions)	183.4	181.8	182.1	177.8	171.1	168.9	162.8	158.1	163.4	192.8	181.3	165.2	168.3
Percent Change - Year Ago	-4.1	-11.9	1.8	-8.6	-6.7	-7.1	-10.6	-11.1	152.1	18.0	-6.0	-8.9	1.9
Mortgage Debt Outstanding ($ billions)	2,127	2,219	2,313	2,401	2,325	2,276	2,250	2,236	1,755	1,957	2,265	2,272	2,248
Homeowners' Equity ($ billions)<1>	1,468	1,471	1,490	1,514	1,541	1,573	1,606	1,639	1,553	1,503	1,486	1,590	1,716
Housing Inventory (millions)	92.0	92.4	92.7	93.1	93.5	93.9	94.3	94.7	89.6	91.1	92.6	94.1	95.5
Rental Vacancy Rate (%)	6.3	6.0	5.9	5.7	5.7	5.8	5.7	5.7	5.6	5.9	5.9	5.7	5.6
Unsold New Homes (% of sales)	53.6	49.8	46.4	47.0	49.9	51.4	54.0	57.3	42.9	50.7	49.2	53.2	56.0
Office Vacancy Rate (%)<2>	10.7	10.4	10.1	9.9	9.7	9.5	9.4	9.3	11.7	13.9	10.3	9.5	9.1
Industrial Vacancy Rate (%)<2>	4.0	3.9	3.8	3.8	3.7	3.7	3.6	3.6	4.9	4.7	3.9	3.6	3.4
New Commercial Building Construction (% Ch Value)	33.8	8.8	0.8	0.3	-0.5	-3.1	-3.7	-1.9	-4.2	37.0	22.6	-0.6	0.3
New Industrial Building Construction (% Ch Value)	6.2	1.7	9.1	3.1	-1.2	0.9	4.6	12.4	-25.7	11.6	8.6	2.9	16.0
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	10.9	7.0	5.7	5.2	5.7	5.4	5.4	5.7	11.2	6.9	6.6	5.6	5.2
M1 Velocity (% change)	-4.1	-1.8	-0.8	0.5	0.5	1.1	1.5	1.9	-3.2	3.7	-0.4	0.5	2.5
M2 (% change)(FED Target 6-9%)	12.5	4.4	8.9	9.2	6.3	5.6	6.7	5.8	12.5	7.9	8.7	6.9	6.1
M2 Velocity (% change)	-5.5	0.6	-3.7	-3.2	-0.1	0.8	0.3	1.7	-4.4	2.7	-2.3	-0.8	1.6
Monetary Base (% change)	6.9	4.7	5.3	4.4	4.7	5.3	5.6	5.7	9.5	8.1	5.8	5.0	5.9
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	664	653	658	676	703	717	726	739	479	653	663	721	791
Private													
Personal Savings	118	159	131	136	142	149	153	154	118	156	136	149	166
Savings Rate	4.5	5.6	4.8	4.9	5.0	5.2	5.2	5.2	5.0	6.1	5.0	5.1	5.3
Gross Business Savings	548	554	559	566	570	580	587	595	454	519	557	583	619
Government													
Federal	-161	-223	-206	-205	-190	-197	-202	-198	-179	-176	-199	-197	-188
State and Local	54	55	55	52	51	51	52	52	44	53	54	51	57
Foreign (current account deficit)	106	109	119	127	130	135	136	136	42	102	115	134	137
Uses (total:gross investment)	651	648	652	668	686	693	706	724	472	638	655	702	772
Nonresidential Investment													
Equipment	290	294	297	299	30[illegible]	310	320	331	223	275	295	316	359
Structures	165	168	169	169	170	173	177	182	130	150	168	175	195
Residential Investment	155	159	168	174	175	177	177	177	132	154	164	176	181
Inventory Investment	41	26	16	25	39	34	32	34	-13	56	27	35	36
Value of the U.S. Dollar (Weighted by Trade) (Base=1967)	1.200	1.170	1.129	1.098	1.073	1.056	1.041	1.026	1.024	1.095	1.149	1.049	0.996
Percent Change	21.5	-9.8	-13.2	-10.5	-8.7	-6.2	-5.7	-5.4	3.7	6.9	5.0	-8.7	-5.0
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	13.3	13.0	12.3	12.0	11.9	12.0	12.0	12.0	13.9	14.2	12.7	12.0	12.6
Real Mortgage Rate (30 yr. avg. is 4.5%)	7.7	10.4	9.6	8.6	8.2	8.3	8.1	7.8	10.2	10.5	9.1	8.1	8.5
1 Year ARM (without buy-down)	11.1	10.2	10.0	10.4	10.5	10.5	10.5	10.9	11.3	12.6	10.4	10.6	11.1
Real Mortgage Rate	5.5	7.7	7.3	7.1	6.8	6.8	6.6	6.7	7.5	9.0	6.9	6.7	6.9
Corporate Bond Rate (AAA)	12.3	11.7	10.9	10.3	10.4	10.3	10.4	10.4	12.0	12.7	11.3	10.4	10.7
Government Bond Rate	11.8	11.1	10.0	9.9	9.8	9.9	9.7	9.9	11.3	12.5	10.7	9.8	10.4
Real Government Bond Rate (30 yr. avg. is 2.1%)	6.2	8.5	7.3	6.5	6.1	6.2	5.8	5.7	7.6	8.9	7.1	5.9	6.3
Federal Funds Rate	8.5	7.9	7.7	7.9	8.2	8.3	8.5	8.8	9.1	10.2	8.0	8.4	9.0
3 Month Treasury Bill Rate	8.2	7.5	7.3	7.6	7.7	7.7	7.8	8.3	8.6	9.5	7.6	7.9	8.4
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	2.6	4.9	4.6	4.3	4.0	4.0	3.9	4.0	4.8	5.9	4.1	4.0	4.3
1 Year Treasury Bill Rate	9.4	8.5	8.3	8.7	8.8	8.8	8.8	9.2	9.6	10.9	8.7	8.9	9.4
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	3.8	6.0	5.6	5.4	5.1	5.1	4.9	5.0	5.8	7.3	5.2	5.0	5.2
Commercial Paper Rate	8.5	7.8	7.6	7.9	8.2	8.3	8.5	8.8	8.9	10.1	8.0	8.4	8.9
Rate on Money Market Fund Shares	8.6	7.9	7.7	8.1	8.3	8.4	8.6	8.9	9.0	10.3	8.0	8.5	9.1
Prime Rate	10.5	10.2	9.6	9.6	9.7	9.8	9.7	10.0	10.8	12.0	10.0	9.8	10.8

<1> Homeowners Equity has been adjusted to correspond to the Federal Reserve's Flow of Funds data.
<2> Historical data courtesy of Coldwell Banker.

[illegible]del developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
[illegible]sumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

JUNE 1985

Table 8

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,817	3,865	3,911	3,966	4,026	4,090	4,160	4,237	3,305	3,663	3,890	4,129	4,450
Percent Change	6.4	5.1	4.8	5.7	6.3	6.5	7.0	7.6	7.7	10.8	6.2	6.1	7.8
Percent Change (without inflation)	0.7	2.5	2.1	2.3	2.5	2.7	3.0	3.3	3.7	6.8	2.5	2.6	3.5
Consumption	5.2	2.6	3.4	2.2	1.9	2.4	2.8	2.8	4.8	5.3	3.6	2.4	3.0
Durables	8.7	3.0	5.1	1.1	-0.2	2.5	3.1	3.6	12.1	13.1	6.2	2.1	4.3
Nondurables	3.5	2.7	3.2	2.2	1.9	2.1	2.4	2.2	3.7	4.6	2.3	2.3	2.5
Services	5.3	2.4	2.9	2.6	2.7	2.7	3.0	2.9	3.4	3.2	3.7	2.7	3.0
Residential Investment	1.4	7.5	19.3	10.7	-0.6	-1.4	-4.0	-3.5	41.7	12.2	3.0	3.4	-1.7
Nonresidential Investment	2.6	5.4	1.5	-0.1	0.2	5.7	8.1	8.3	2.5	19.8	6.3	3.1	8.4
Structures	16.8	5.4	-0.2	-2.7	-2.2	1.2	5.8	5.5	-7.8	15.6	9.5	0.5	6.3
Equipment	-2.5	5.5	2.2	0.9	1.2	7.4	8.9	9.4	7.3	21.5	5.1	4.2	9.3
Exports	-6.1	2.1	3.8	6.4	6.7	7.3	9.3	10.0	-5.6	4.7	0.4	6.7	8.6
Imports	31.3	-1.5	8.0	7.1	5.3	4.6	4.0	5.0	7.6	27.0	7.9	5.2	4.9
Government Purchases	-1.8	6.0	2.9	0.5	0.2	4.4	0.1	0.2	-0.3	3.5	3.9	1.7	1.2
Consumption (% of GNP)	65.4	65.4	65.6	65.6	65.5	65.5	65.4	65.4	65.8	64.8	65.5	65.5	65.2
Residential Investment (% of GNP)	3.6	3.6	3.8	3.8	3.8	3.8	3.7	3.6	3.5	3.7	3.7	3.7	3.5
Nonresidential Investment (% of GNP)	12.9	13.0	13.0	12.9	12.8	12.9	13.1	13.2	11.1	12.5	13.0	13.0	13.7
Structures (% of GNP)	3.7	3.7	3.7	3.7	3.6	3.6	3.6	3.7	3.2	3.5	3.7	3.6	3.7
Equipment (% of GNP)	9.2	9.3	9.3	9.3	9.2	9.3	9.5	9.6	7.9	9.0	9.3	9.4	9.9
Inventory Change ($ billions)	40.6	26.2	17.8	25.3	38.6	33.6	32.5	34.3	-13.5	58.2	27.5	34.7	36.3
Mfg. Capacity Utilization Rate (%)	81	80	80	80	80	81	81	81	75	82	81	81	82
Auto Sales (millions of units)	10.8	10.8	10.8	10.7	10.5	10.5	10.6	10.6	9.2	10.4	10.8	10.5	10.9
Domestic (% of total)	78.0	77.3	73.3	72.1	73.4	72.3	69.0	67.2	74.0	76.4	75.2	70.5	67.4
Imported (% of total)	22.0	22.7	26.7	27.9	26.6	27.7	31.0	32.8	26.0	23.5	24.8	29.5	32.6
Manufacturing Industrial Production (% change)	0.6	0.2	3.4	2.9	3.1	3.6	2.7	4.2	7.8	11.2	1.8	3.0	5.2
Common Market	3.7	2.3	3.0	2.2	2.1	2.6	1.5	3.1	0.9	3.2	2.8	2.3	1.3
Japan	-2.7	2.2	4.0	5.7	11.7	3.0	0.7	1.6	3.5	11.0	4.0	5.3	1.0
Employment(millions)(civilian:household basis)	106.7	107.2	107.5	107.9	108.2	108.5	108.8	109.1	100.8	105.0	107.3	108.6	110.9
Percent Change	3.0	1.6	1.4	1.3	1.1	1.1	1.2	1.3	1.3	4.1	2.2	1.2	2.1
Unemployment Rate (%) (civilian),	7.3	7.4	7.5	7.6	7.7	7.8	7.8	7.6	9.6	7.5	7.5	7.8	7.6
Personal Income per Household (average)<1>	40,045	40,439	40,866	41,394	41,979	42,635	43,287	43,924	35,415	38,526	40,666	42,956	45,754
Percent Change -- Year Ago (w/o inflation)	3.4	2.2	1.7	1.4	1.3	1.8	2.0	1.9	1.5	5.4	2.2	1.8	2.4
Personal Taxes per Household (average)	7,724	7,231	7,574	7,686	7,831	7,984	8,115	8,265	6,478	6,956	7,554	8,049	8,656
Percent Change -- Year Ago (w/o inflation)	10.3	1.1	4.2	3.6	-1.6	6.8	3.4	3.5	-3.0	3.5	4.0	2.9	3.3
Percent of Personal Income	20.2	18.7	19.4	19.4	19.5	19.6	19.6	19.7	19.1	18.8	19.4	19.6	19.3
Disposable Income per Household (average)	32,321	33,208	33,292	33,708	34,148	34,651	35,172	35,659	28,938	31,571	33,132	34,907	37,097
Percent Change--Year Ago (w/o inflation)	2.0	2.8	1.4	1.2	2.2	0.8	1.8	1.7	2.5	5.7	1.8	1.6	2.1
Household Interest Payments (% of total)	10.4	10.4	10.8	10.7	10.6	10.5	10.5	10.0	9.8	10.4	10.6	10.4	9.5
Net Worth Per Household (average)	81,272	82,984	84,409	85,925	87,432	88,822	90,049	91,362	73,838	77,705	83,648	89,417	95,696
Percent Change--Year Ago (w/o inflation)	3.4	4.7	3.4	4.0	4.4	3.6	2.9	2.4	7.6	1.4	3.9	3.3	2.8
Consumer Price Inflation (CPI)	3.3	3.6	3.4	3.7	3.9	4.0	4.2	4.2	3.2	4.3	3.5	3.6	4.3
Gross National Product Inflation (GNP Deflator)	5.6	2.6	2.7	3.4	3.7	3.7	3.9	4.2	3.8	3.8	3.6	3.5	4.1
Personal Consumption Inflation	3.3	3.2	3.0	3.4	3.8	3.9	4.1	4.3	3.7	3.2	3.1	3.7	4.0
Residential Construction Inflation	4.1	3.0	3.3	3.3	4.1	4.9	4.9	5.0	1.7	3.9	3.6	4.1	4.7
Nonresidential Construction Inflation	2.6	1.7	2.9	3.3	4.3	4.4	4.5	4.9	-1.0	0.3	2.1	3.9	4.5
Producers Price Inflation (WPI)	-2.0	0.9	0.7	2.5	2.3	2.4	3.0	3.6	1.3	2.4	0.0	2.2	3.6
Compensation per Manhour (% change)	6.0	3.9	4.1	4.2	6.1	5.3	5.4	5.7	4.8	4.2	4.4	5.1	5.4
Productivity (% change)	-1.5	1.7	1.5	1.6	1.0	0.9	1.5	1.8	3.4	2.7	0.8	1.3	1.9
Unit Labor Cost (% change)	7.4	2.2	2.5	2.6	5.0	4.3	3.8	3.8	1.3	1.4	3.5	3.7	3.5
Unit Capital Cost (% change)	4.1	3.8	3.5	3.1	2.7	2.4	2.2	2.0	6.9	4.6	3.6	2.3	1.9
Before Tax Corporate Profits ($ billions)<2>	231	224	221	221	223	224	228	233	213	243	224	227	260
Corporate Tax Liability	91	85	83	83	85	85	86	88	86	96	85	86	102
After Tax Profits	140	139	138	139	138	139	142	145	127	146	139	141	158
Inventory Valuation Adjustment	1	-3	-5	-10	-12	-12	-15	-18	-11	-6	-4	-14	-21
Capital Consumption Adjustment	69	74	78	84	86	89	90	92	33	56	77	89	85
Profits from Current Production (with IVA, CCA)	210	210	211	213	212	216	217	219	149	196	211	216	223
Adjusted for Inflation (84:3 base)	206	205	204	205	202	203	203	202	156	197	205	202	201
Percent Change - Year Ago	9.3	3.8	2.1	1.0	-1.9	-0.7	-0.6	-1.3	46.0	26.5	4.0	-1.1	-0.8
Per Unit of Output (% of GNP)	5.5	5.4	5.4	5.4	5.3	5.3	5.2	5.2	4.5	5.3	5.4	5.2	5.0
Effective Corporate Tax Rate (%)<2>	29	28	27	27	28	27	28	28	34	32	28	28	31
Federal Tax Receipts (Unified basis)	696	809	735	672	665	913	756	721	613	683	728	764	833
Percent of GNP	18.2	20.9	18.8	16.9	16.5	22.3	18.2	17.0	18.6	18.7	18.7	18.5	18.7
Federal Expenditures (Unified basis)	919	941	954	954	964	978	989	1,008	803	868	942	985	1,043
Percent of GNP	24.1	24.4	24.4	24.1	23.9	23.9	23.8	23.8	24.3	23.7	24.2	23.9	23.4
Surplus or Deficit (Unified basis)	-223	-132	-219	-282	-299	-65	-233	-286	-190	-184	-214	-221	-210
% of GNP	5.8	3.4	5.6	7.1	7.4	1.6	5.6	6.8	5.8	5.0	5.5	5.3	4.7
% of Personal Savings	186.3	83.2	167.5	207.9	210.7	43.7	151.9	186.4	158.1	117.2	161.7	148.2	125.1
% of Net Domestic Savings	74.9	38.9	70.8	90.7	95.6	20.2	71.5	88.1	80.0	56.5	68.8	68.9	61.1

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

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JULY 1985

The Outlook for the Economy and Real Estate

Aggregate Economy

A growth recession occurs when growth in real output remains near 2 percent or less leading to a rise in the unemployment rate. Evidence of a possible growth recession currently evolving has been an increase in real output of only 2.2 percent over the past 12 months compared to 7.3 percent growth over the previous 12 months. Underscoring this slowing trend has been continued weakening in spending and production over recent months.

This trend towards more sluggish growth will likely continue despite the unexpectedly strong GNP "flash" estimate of 3.1 percent for the second quarter. There is a strong likelihood that the 2nd quarter flash will be revised down once more complete information from mid-May to June is included. Furthermore, most of the growth in real output during the second quarter is a result of the windfall gains in income that occurred in response to the long overdue tax refunds. Once the stimulative effects from these refunds wear off in the third quarter, slower economic activity should dominate through 1985 with real output growth remaining near 2 percent for the rest of the year.

Historically, a growth recession has lasted on average five quarters and in five out of six times resulted in a recession. However, the distinctive feature of declining interest rates in our current slowdown will likely stimulate a rebound in the interest sensitive sectors of the economy by 1986, thus preventing a recession from occurring. In the absence of a further decline in the dollar, the economy's responsiveness to reduced interest rates will largely be exported abroad. A further contraction in domestic manufacturing activity is likely to occur, keeping domestic output from reaching its full potential.

The most hard-hit sector of the economy has been manufacturing. The loss of competiveness of domestic producers has dampened manufacturing growth to a 2 percent rate over the last four quarters, compared to a 12.3 percent rate reached during the previous four. No relief is in sight as the barometers of future manufacturing activity--manufacturing employment as well as industrial production--have not risen since last summer.

Employment and Inflation

The outlook for employment has become increasingly worrisome. As slow economic activity continues, average hours worked has begun to falter. Subsequently, an eventual stagnation and possible decline in overall employment growth through 1985 is expected. Employment growth in manufacturing has already shown signs of weakening as the cumulative loss in manufacturing employment has totaled 163,000 jobs or 0.8 percent since January. In response to the slowing in overall employment growth, the civilian unemployment rate has remained virtually unchanged at 7.2 percent over the past 4 months and is expected to increase through 1985 and 1986.

One of the few bright spots in the economy has been the continued low rate of inflation. The Consumer Price Index (CPI) increased a modest 0.2 percent in May resulting in an increase of only 3.7 percent over the past 12 months. Some components within the CPI have experienced larger increases than others over the past 12 months. For instance, price increases for services have been running ahead of that for goods for some time now. Underlying the increasing costs of services is the continued increase in medical care and transportation services. While overall inflation is expected to remain below 4 percent through 1986, service price inflation is expected to accelerate more as wage costs accelerate and gas and electricity prices pick-up.

Monetary Policy and Interest Rates

Recently, the behavior of the money supply has been distorted due to the technical factor of delayed tax refunds. In April, the delay in refunds resulted in a most unusual decline in M2 bringing it well within the Federal Reserves (FED) target. Once the bulk of refunds were finally mailed out in May, M2 rose accordingly.

Although the money supply as measured by M1 (currency in circulation and checkable deposits) will likely be above its target, the FED will not be as quick to correct for this overrun as it has done in the past. Instead, given the mounting evidence of a significant slowing in the economy, the FED is more concerned about diverting a recession and will therefore continue to ease credit conditions as indicators of slower growth persist. The likely result is a continued downward trend in both short and long term interest rates through the remainder of 1985. However, as credit demands heat up in response to lower rates by mid-1986, short-term rates should start to trend upward. Long-term rates, on the other hand, should continue to trend downward through 1986 as confidence about stable prices in the future dominates.

Fiscal Policy

Federal deficits, despite efforts to trim them, will still top $200 billion next year because of the continued slowing in economic activity. Almost half of the deficit savings proposed for next year has been eroded by the pessimistic outlook for the economy's performance. The continued reliance on the assumption of 4 percent real growth for the economy will distort the budget estimates presently under discussion by the House and Senate conferees leading to an unexpected increase in the federal deficit next year. Further, a consensus opinion is emerging that tax reform legislation proposed by the Administration would add to the enormous federal deficits. At this juncture, radical tax reform is not likely in 1985 or 1986.

Real Estate Markets

Activity in the housing market remains at healthy levels as mortgage interest rates have hit five-year lows. The seasonally adjusted annual rate of existing single family home sales remained above the 3 million unit level in May for the third consecutive month and was 1.3 percent above the May 1984 pace. Resales are expected to improve further throughout the year with 3.1 million existing homes expected to be sold in 1985. This would be the best resale volume since 1979 when 3.8 million units were sold. Resales should remain strong through 1986.

The continued volatility in total housing starts is largely due to huge swings in multi-family starts while single family starts remain at healthy levels. The declines in total starts in May can largely be attributed to the softening condominium market and apartment sector in many cities. Sales of condominiums are falling because the condominium market has in many cases filled its niche in the housing market. First time homebuyers who could not afford to purchase a single family home, already have purchased a condominium and are now moving up to a detached home. In addition, with interest rates lower than they were earlier in the decade, many first time buyers are able to move directly into single family homes rather than begin with a condominium.

Over the past month, mortgage rates have continued to fall. At the end of May the commitment rate for 30-year fixed rate mortgages published by the Federal Home Loan Mortgage Corporation fell to 12.7 percent. The decline in mortgage rates has stimulated a move back to fixed rate mortgages as homebuyers tend to prefer the certainty of a fixed rate. Consequently, the share of variable rate contracts has fallen.

Nonresidential construction has exhibited strong growth over the last few years, especially in retail, office and non-manufacturing warehouse construction. From this point of time the outlook remains mixed. Retail is expected to fare favorably over the next few years as the current high level in housing starts accompanied by increases in purchasing power continues to stimulate demand for retail space. In fact, retail construction is still in short supply, and has yet to approach peaks reached during the previous business cycles.

The outlook for office construction is not as favorable as both demand and supply conditions are adversely affecting future construction. The ability to finance a project has become increasingly important because most projects are very large. The recent declines in corporate profits accompanied by an increase in the debt service burden of non-financial corporations; and the availability of existing capacity will dampen the ability and interest of businesses to finance office construction; leading to an overall decline in this area over the next few years.

JULY 1985

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,811	3,865	3,908	3,955	3,996	4,043	4,097	4,166	3,305	3,663	3,884	4,075	4,388
Percent Change	5.6	5.8	4.6	4.8	4.3	4.7	5.4	6.9	7.7	10.8	6.1	4.9	7.7
Percent Change (without inflation)	0.3	3.1	2.2	1.7	1.0	1.3	1.7	2.8	3.7	6.8	2.5	1.7	3.4
Consumption	5.2	5.0	2.7	0.7	1.7	1.4	1.8	2.1	4.8	5.3	3.9	1.8	2.9
Durables	9.2	6.6	5.1	-2.4	-0.9	-0.2	0.5	2.6	12.1	13.1	6.8	0.5	3.4
Nondurables	3.7	6.8	1.6	0.9	1.6	1.1	1.3	1.1	3.7	4.6	2.8	1.6	2.1
Services	5.0	3.0	2.8	1.7	2.6	2.3	2.7	2.8	3.4	3.2	3.6	2.4	3.3
Residential Investment	5.5	3.8	22.5	11.3	4.5	-2.3	-0.1	1.3	41.7	12.2	3.8	5.6	-0.3
Nonresidential Investment	-1.5	9.8	3.1	-0.3	2.0	1.7	6.5	6.4	2.5	19.8	6.2	2.8	6.7
Structures	9.5	8.7	-0.7	-2.0	-1.8	1.9	7.0	5.6	-7.8	15.6	8.3	1.1	7.0
Equipment	-5.6	10.3	4.6	-0.4	3.6	1.6	6.3	6.8	7.3	21.5	5.3	3.5	6.6
Exports	-8.9	-6.5	3.3	6.8	9.3	8.8	9.1	9.2	-5.6	4.7	-1.9	7.3	9.0
Imports	32.2	2.4	9.0	7.2	2.5	0.1	0.1	1.3	7.6	27.0	9.0	3.3	3.3
Government Purchases	0.3	1.9	4.2	0.5	0.4	0.1	0.4	0.5	-0.3	3.5	3.8	0.9	0.8
Consumption (% of GNP)	65.5	65.8	65.8	65.7	65.8	65.8	65.8	65.7	65.8	64.8	65.7	65.8	65.4
Residential Investment (% of GNP)	3.6	3.6	3.8	3.9	3.9	3.9	3.8	3.8	3.5	3.7	3.7	3.9	3.7
Nonresidential Investment (% of GNP)	12.8	13.0	13.0	13.0	13.0	13.0	13.1	13.3	11.1	12.5	12.9	13.1	13.5
Structures (% of GNP)	3.7	3.7	3.7	3.6	3.6	3.6	3.7	3.7	3.2	3.5	3.7	3.6	3.8
Equipment (% of GNP)	9.1	9.3	9.4	9.3	9.4	9.4	9.5	9.6	7.9	9.0	9.3	9.5	9.7
Inventory Change ($ billions)	40.7	36.6	28.0	37.4	25.4	19.6	6.7	4.0	-13.5	58.2	35.7	13.9	16.7
Mfg. Capacity Utilization Rate (%)	81	80	80	80	79	79	79	79	75	82	80	79	81
Auto Sales (millions of units)	10.8	11.2	11.0	10.8	10.7	10.5	10.4	10.5	9.2	10.4	11.0	10.5	10.8
Domestic (% of total)	78.0	76.1	71.7	71.3	72.4	71.2	67.5	65.8	74.0	76.5	74.3	69.2	66.0
Imported (% of total)	22.0	23.9	28.3	28.7	27.6	28.8	32.5	34.2	26.0	23.5	25.7	30.8	34.0
Manufacturing Industrial Production (% change)	0.9	0.5	1.8	0.9	2.1	1.6	1.9	4.2	7.8	11.2	1.6	1.8	5.2
Common Market	3.4	3.5	3.3	2.1	2.1	2.1	1.2	2.4	0.9	3.2	3.0	2.2	1.2
Japan	0.4	5.7	6.9	5.8	11.7	5.6	4.2	2.9	3.5	11.0	5.8	6.9	1.6
Trade Deficit	120	130	139	143	142	141	139	137	41	102	133	140	138
Value of the U.S. Dollar (Weighted by Trade)	1.350	1.312	1.278	1.246	1.215	1.193	1.175	1.155	1.142	1.224	1.297	1.185	1.110
Percent Change	22.5	-10.7	-9.9	-9.7	-9.8	-6.9	-5.9	-6.5	4.0	7.2	6.0	-8.6	-6.3
Employment(millions)(civilian:household basis)	106.7	107.1	107.5	107.9	108.1	108.3	108.5	108.7	100.8	105.0	107.3	108.4	110.2
Percent Change	3.0	1.2	1.6	1.4	0.8	0.8	0.6	0.7	1.3	4.1	2.2	1.0	1.7
Unemployment Rate (%) (civilian)	7.3	7.3	7.4	7.4	7.6	7.7	7.9	8.0	9.6	7.5	7.4	7.8	7.9
Personal Income per Household (average)<1>	40,078	40,475	40,897	41,323	41,617	42,255	42,814	43,414	35,416	38,527	40,693	42,575	45,343
Percent Change -- Year Ago (w/o inflation)	3.5	2.4	2.0	1.5	1.1	0.9	0.8	0.9	1.5	5.4	2.3	0.9	2.2
Personal Taxes per Household (average)	7,740	7,208	7,596	7,820	7,913	8,009	8,119	8,262	6,478	6,956	7,591	8,076	8,660
Percent Change -- Year Ago (w/o inflation)	10.6	0.9	4.7	5.6	-0.5	7.9	3.4	2.0	-3.0	3.5	5.4	3.1	3.0
Percent of Personal Income	20.2	18.6	19.4	19.8	19.8	19.8	19.9	19.9	19.1	18.8	19.5	19.9	20.0
Disposable Income per Household (average)	32,338	33,267	33,302	33,503	33,903	34,246	34,696	35,152	28,938	31,571	33,102	34,499	36,682
Percent Change--Year Ago (w/o inflation)	2.0	2.9	1.6	0.8	1.7	0.4	0.4	0.9	2.5	5.7	1.8	0.6	2.0
Household Debt (% of total)	23.1	23.2	23.7	24.0	24.2	24.2	24.2	24.1	19.7	21.2	23.5	24.2	23.6
Household Interest Payments (% of total)	10.3	10.4	10.9	10.9	10.8	10.8	10.7	10.2	9.7	10.4	10.6	10.6	9.9
Consumer Price Inflation (CPI)	3.3	3.8	3.2	3.3	3.5	3.5	3.7	4.3	3.2	4.3	3.5	3.5	4.2
Gross National Product Inflation (GNP Deflator)	5.4	2.6	2.3	3.1	3.3	3.4	3.7	4.0	3.8	3.8	3.5	3.2	4.1
Personal Consumption Inflation	3.3	2.7	2.7	3.2	3.7	3.9	4.2	4.2	3.7	3.2	3.0	3.6	4.2
Residential Construction Inflation	-0.6	2.8	3.1	3.1	4.7	4.8	4.8	4.7	1.7	3.9	2.4	4.1	4.9
Nonresidential Construction Inflation	3.4	1.8	2.6	2.8	3.8	3.9	3.9	4.2	-1.0	0.3	2.2	3.4	4.4
Producers Price Inflation (WPI)	-2.1	0.4	0.8	2.2	1.8	2.0	2.7	3.4	1.3	2.4	-0.1	1.9	3.5
Compensation per Manhour (% change)	5.5	3.6	2.9	3.8	5.3	4.5	4.9	5.3	4.8	4.2	4.0	4.4	5.4
Productivity (% change)	-2.6	1.9	1.0	0.8	0.5	0.9	0.9	1.5	3.4	2.7	0.5	0.9	1.9
Unit Labor Cost (% change)	8.2	1.6	1.9	3.0	4.7	3.6	4.0	3.8	1.3	1.4	3.5	3.5	3.4
Before Tax Corporate Profits ($ billions)<2>	229	224	221	218	222	224	224	232	213	243	223	225	267
Corporate Tax Liability	92	86	84	82	84	84	83	87	86	98	86	85	106
After Tax Profits	137	138	138	137	138	139	141	145	127	146	137	140	160
Inventory Valuation Adjustment	1	3	-6	-11	-12	-13	-16	-18	-11	-6	-5	-15	-22
Capital Consumption Adjustment	69	74	80	87	87	85	84	85	33	56	78	85	81
Profits from Current Production (with IVA, CCA)	207	210	211	212	212	211	209	211	149	196	210	211	220
Adjusted for Inflation (84:3 base)	203	204	205	204	203	199	196	196	156	197	204	198	199
Percent Change - Year Ago	7.9	3.7	2.5	0.7	-0.2	-2.5	-4.4	-4.0	46.0	26.5	3.6	-2.8	0.2
Per Unit of Output (% of GNP)	5.4	5.4	5.4	5.4	5.3	5.2	5.1	5.1	4.5	5.3	5.4	5.2	5.0
Effective Corporate Tax Rate (%)<2>	30	28	27	27	27	28	28	28	34	32	28	28	32
Federal Tax Receipts (Unified basis)	696	808	738	682	669	913	753	718	613	683	731	763	833
Percent of GNP	18.3	20.9	18.9	17.3	16.7	22.6	18.4	17.2	18.6	18.7	18.8	18.7	19.0
Federal Expenditures (Unified basis)	919	934	949	948	963	967	976	993	803	868	938	975	1,035
Percent of GNP	24.1	24.2	24.3	24.0	24.1	23.9	23.8	23.8	24.3	23.7	24.1	23.9	23.6
Surplus or Deficit (Unified basis)	-223	-126	-211	-266	-295	-53	-224	-275	-190	-184	-206	-212	-202
% of GNP	5.8	3.3	5.4	6.7	7.4	1.3	5.5	6.6	5.8	5.0	5.3	5.2	4.6
% of Personal Savings	187.8	83.7	168.5	216.6	231.8	41.7	169.1	204.5	158.1	117.2	164.1	161.8	134.9
% of Net Domestic Savings	75.5	38.2	69.5	90.3	100.2	18.4	76.9	93.8	80.0	56.5	68.4	72.3	63.2

<1> Includes personal contributions for social insurance.

<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 2

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual	Forecast							Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	4,057	4,122	4,270	4,312	4,264	4,276	4,277	4,275	3,750	3,936	4,190	4,273	4,140
Percent Change -- Year Ago	-1.9	1.6	14.7	12.7	5.1	3.7	0.1	-0.9	42.4	5.0	6.5	2.0	-3.1
Existing Single-Family Home Sales (thousands)	2,970	3,055	3,080	3,095	3,099	3,110	3,115	3,120	2,716	2,866	3,050	3,111	3,020
Percent Change - Year Ago	1.9	2.8	11.5	10.0	4.4	1.8	1.1	0.8	36.5	5.5	6.4	2.0	-2.9
Dollar Volume (billions)	261.3	271.8	273.9	268.8	274.7	281.1	282.7	277.2	224.2	247.1	268.9	278.9	280.1
Existing Home Prices - Median ($1000's)	73.8	75.4	76.0	74.6	76.6	78.4	78.9	77.5	69.8	72.3	75.0	77.8	81.2
Percent Change - Year Ago	3.6	3.7	3.8	3.7	3.7	3.9	3.9	3.8	3.2	3.5	3.7	3.8	4.3
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	657	649	630	605	611	616	611	600	628	680	635	609	648
Percent of Median Family Income	30	29	28	27	27	27	26	25	32	32	28	26	26
Private Housing Starts (thousands)	1,795	1,791	1,939	1,977	1,891	1,901	1,904	1,904	1,703	1,766	1,875	1,900	1,850
Percent Change - Year Ago	-7.8	-3.6	16.6	23.7	5.4	6.2	-1.8	-3.7	61.0	3.8	6.2	1.3	-2.6
Single-Family	1,121	1,100	1,227	1,254	1,201	1,202	1,197	1,191	1,066	1,103	1,176	1,198	1,155
Percent of Total	62.5	61.5	63.3	63.5	63.5	63.2	62.9	62.5	62.6	62.4	62.7	63.0	62.4
Multi-Family	674	690	713	722	691	699	707	713	637	664	700	702	695
Percent of Total	37.5	38.5	36.7	36.5	36.5	36.8	37.1	37.5	37.4	37.6	37.3	37.0	37.6
Mobile Home Shipments	277	288	299	302	300	302	305	304	296	295	292	303	300
New Single-Family Home Sales (thousands)	662	630	642	659	665	675	680	650	627	637	649	667	620
Percent Change - Year Ago	-4.0	-0.4	4.6	6.8	0.5	7.2	6.0	-1.4	49.9	-1.5	1.8	2.8	-7.1
New Home Prices - Median ($1000's)	83.2	84.2	85.0	85.9	87.4	88.9	90.4	91.7	75.5	80.0	84.6	89.6	94.8
Percent Change - Year Ago	6.8	4.6	4.5	7.0	5.0	5.6	6.4	6.7	8.9	6.0	5.7	5.9	5.8
New Home Prices--Mean ($1000's, Quality Adjusted)	96.2	95.2	96.6	97.2	99.5	98.9	100.8	101.8	89.7	93.7	96.3	100.2	105.2
Percent Change - Year Ago	5.7	1.9	1.6	2.1	3.4	3.[illegible]	4.4	4.8	2.1	4.5	2.8	4.1	4.9
NAR Affordability Index	88.4	90.2	93.5	96.6	96.1	95.4	96.5	99.2	82.0	86.2	92.2	96.8	98.0
Mortgage Debt Outstanding ($ billions)	2,257	2,613	2,912	3,166	3,382	3,574	3,747	3,906	1,755	1,957	2,737	3,652	4,254
Homeowners' Equity ($ billions)	2,253	2,262	2,270	2,279	2,301	2,323	2,346	2,369	2,242	2,278	2,266	2,335	2,435
Housing Inventory (millions)	95.3	95.7	96.1	96.6	97.0	97.5	97.9	98.3	92.7	94.4	95.9	97.7	99.4
Rental Vacancy Rate (%)	6.3	6.0	5.9	5.8	5.8	5.8	5.9	5.9	5.6	5.9	6.0	5.8	5.9
Office Vacancy Rate (%)<1>	10.7	10.4	10.1	9.9	9.7	9.5	9.4	9.3	11.7	13.9	10.3	9.5	9.1
Industrial Vacancy Rate (%)<1>	4.0	3.9	3.8	3.8	3.7	3.7	3.6	3.6	4.9	4.7	3.9	3.6	3.4
New Commercial Building Construction (% Ch Value)	32.8	16.5	0.2	-0.6	-1.2	1.0	2.5	3.8	-4.2	37.0	23.8	1.3	7.2
New Industrial Building Construction (% Ch Value)	-2.0	14.1	4.4	1.5	-1.3	3.5	7.0	13.2	-25.7	11.6	8.1	3.7	15.8
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	10.9	9.9	5.2	5.5	5.7	5.5	6.1	5.7	11.2	6.9	7.2	5.9	5.8
M1 Velocity (% change)	-4.8	-3.8	-0.6	-0.7	-1.4	-0.8	-0.6	1.1	-3.2	3.7	-1.0	-0.9	1.8
M2 (% change)(FED Target 6-9%)	12.6	5.3	9.2	6.4	5.3	4.6	7.3	7.1	12.5	7.9	8.8	6.2	6.7
M2 Velocity (% change)	-6.2	0.4	-4.3	-1.4	-1.0	0.1	-1.7	-0.1	-4.4	2.7	-2.5	-1.2	0.9
Monetary Base (% change)	6.8	7.0	6.8	5.6	5.2	4.2	5.1	5.5	9.5	8.1	6.5	5.4	5.2
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	671	672	679	690	698	702	703	716	478	653	678	705	773
Private													
Personal Savings	119	151	125	123	127	128	132	135	118	156	129	130	149
Savings Rate	4.5	5.5	4.6	4.4	4.5	4.5	4.6	4.6	5.0	6.1	4.8	4.5	4.8
Gross Business Savings	544	552	559	563	568	573	579	586	454	519	554	576	612
Government													
Federal	-165	-217	-198	-189	-185	-185	-192	-187	-179	-176	-192	-188	-180
State and Local	54	55	54	49	47	46	45	46	44	53	53	46	53
Foreign (current account deficit)	120	130	139	143	142	141	139	137	41	102	133	140	138
Uses (total:gross investment)	647	657	663	680	677	678	679	691	472	638	662	681	745
Nonresidential Investment													
Equipment	288	296	300	301	305	309	316	324	223	275	296	314	346
Structures	163	167	168	168	169	171	176	180	130	150	167	174	195
Residential Investment	155	158	167	173	177	178	180	183	132	154	163	179	187
Inventory Investment	41	37	28	37	25	20	7	4	-13	58	36	14	17
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	13.7	13.2	12.7	12.4	12.2	12.0	11.8	11.8	13.8	14.5	13.0	11.9	12.2
Real Mortgage Rate (30 yr. avg. is 4.5%)	8.3	10.6	10.4	9.3	8.9	8.6	8.1	7.8	10.1	10.9	9.7	8.3	7.9
1 Year ARM (without buy-down)	11.1	10.2	10.0	10.0	9.7	9.4	9.6	9.7	11.3	12.6	10.3	9.6	10.3
Real Mortgage Rate	5.7	7.6	7.7	6.9	6.4	6.0	5.9	5.7	7.5	9.0	7.0	6.0	6.0
Corporate Bond Rate (AAA)	12.3	11.2	10.5	10.5	10.2	10.1	9.8	9.8	12.0	12.7	11.1	10.0	10.1
Government Bond Rate	11.8	10.8	10.0	10.0	9.8	9.7	9.3	9.3	11.3	12.5	10.6	9.5	9.7
Real Government Bond Rate (30 yr. avg. is 2.1%)	6.4	8.2	7.7	6.9	6.5	6.3	5.6	5.3	7.6	8.9	7.3	5.9	5.4
Federal Funds Rate	8.5	7.8	7.4	7.5	7.0	7.0	7.1	7.3	9.1	10.2	7.8	7.1	8.2
3 Month Treasury Bill Rate	8.2	7.4	7.2	7.2	6.9	6.6	6.8	6.9	8.6	9.5	7.5	6.8	7.5
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	2.8	4.8	4.9	4.1	3.6	3.2	3.1	2.9	4.8	5.9	4.2	3.2	3.2
1 Year Treasury Bill Rate	9.4	8.5	8.3	8.3	8.0	7.7	7.9	8.0	9.6	10.9	8.6	7.9	8.6
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	4.0	5.9	6.0	5.2	4.7	4.3	4.2	4.0	5.8	7.3	5.3	4.3	4.3
Commercial Paper Rate	8.5	7.8	7.4	7.5	7.1	7.0	7.1	7.3	8.9	10.1	7.8	7.1	8.1
Rate on Money Market Fund Shares	8.6	7.8	7.5	7.6	7.1	7.1	7.2	7.4	9.0	10.3	7.9	7.2	8.2
Prime Rate	10.5	10.2	9.4	9.2	8.8	8.9	8.9	8.9	10.8	12.0	9.8	8.9	9.8

<1> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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OUTLOOK

FOR THE ECONOMY AND REAL ESTATE

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Outlook for the Economy and Real Estate

Aggregate Economy

The recovery has been interrupted by a growth recession with economic growth slowing to one percent for the first half of 1985 compared to 8.8 percent during the first half of 1984 and 2.9 percent during the second half of last year. During the first quarter Gross National Product (GNP) grew a mere 0.3 percent while during the second quarter GNP increased a modest 1.7 percent. While domestic spending continued to expand at a healthy pace, domestic production remained stagnant as the overvalued dollar, which is the result of record federal deficits, resulted in increased spending on imported goods and services and decreased demand for U.S. products in international markets. Continued growth in imports combined with declining exports resulted in a $5.1 billion decline in net exports during the second quarter which reduced GNP growth by 1.3 percentage points. In addition, an unexpectedly sharp $13.3 billion decline in domestic inventory investment cut another 3.2 percentage points from second quarter real output growth.

Second quarter real GNP growth would have been considerably higher in the absence of the negative impacts of declining net exports and reduced inventory investment, as evidenced by healthy growth in consumption and investment spending. In fact, final sales, defined as GNP less changes in business inventories, contributed 4.9 percentage points to real output growth during the second quarter, reflecting the underlying strength still present in domestic demand. Both residential and nonresidential investment showed considerable vigour due to lower interest rates. Fear of tax increases on investment appears to have added to purchases of equipment as several tax proposals currently under consideration would repeal the Investment Tax Credit and other investment incentives in 1986.

Despite near-recession growth during the first half of this year, a modest rebound is expected for the rest of 1985, due to the stimulative effects of lower interest rates as well as an expected stabilization in domestic inventories. Real GNP growth is expected to range between 2 1/2 to 3 percent during the remainder of 1985 despite slower growth of consumption spending and fixed investment. However, by 1986 the economic expansion that will have lasted 12 quarters should again lose steam with slow growth persisting throughout the year.

Lower interest rates, rapid growth of the money supply, and a slowing economy have recently caused some nervousness among foreign investors in dollar denominated assets. In response, the dollar, after climbing over the past four years, has begun to decline. However, the recent 15 percent depreciation of the dollar is not likely to reduce our trade deficit until well into 1986. This is due to the fact that there is a long lag between the rise in import prices and reduced prices of U.S. products abroad and changes in the flow of imports and exports. In the meantime, domestic purchases of foreign goods will remain strong with the total value of imports continuing to rise. As the dollar continues to decline in relation to other currencies and economic expansions abroad continue, growth in exports should start to increase while import growth slows. By 1986, the trade deficit should begin to stabilize. However, total elimination of the trade deficit is not likely until the next century given the paralysis of government regarding the federal deficit.

The fate of the dollar strongly influences the outlook for interest rates. If the dollar continues to depreciate rapidly foreign investors will be less willing to finance the federal deficit, resulting in greater competition for the supply of domestic savings leading to higher interest rates. Thus, for now the Federal Reserve Board has done all that it can to reduce interest rates. Further significant reductions in interest rates will require significant reductions in the deficit which the President and the Congress have been unwilling to adopt.

Employment and Inflation

Nonfarm payroll employment increased by 243,000 in July compared to a modest 28,000 increase in June. The larger employment increase in July reflects the modest rebound in economic activity expected for the third quarter. However, the civilian unemployment rate remained at 7.3 percent for the sixth consecutive month as the increases in employment are just keeping pace with increases in the labor force. The unemployment rate would be even higher if the large number of discouraged workers were counted amount the unemployed. Further, employment in goods-producing industries increased by just 12,000 in July whereas employment in service producing industries increased by 231,000. Manufacturing employment continued to decline as the competitiveness of domestic manufacturers in international markets continues to be hindered by the over-valued dollar. The unemployment rate should start rising later this year and into 1986 in response to slower economic growth.

The modest acceleration in inflation during the second quarter of this year was due primarily to increases in gasoline prices this past spring. During the second half of 1985 energy prices should stabilize or even fall and so help to hold down overall price increases. After rising at an annual rate of 4.2 percent during the second quarter, the Consumer Price Index should rise at an annual rate of 3 to 3 1/2 percent over the second half of 1985 and should remain at that rate in 1986 before accelerating in 1987 in response to acceleration in overall economic growth.

Fiscal Policy

Congress passed a budget resolution for fiscal year 1986 which, according to the respective budget committees, will result in $55 billion of deficit reduction in FY86 and $277 billion of deficit reduction for fiscal years 1986 to 1988 with no significant tax increases and no changes in the cost-of-living adjustment formula for Social Security and other federal retirement programs. However, actual deficit reduction is likely to be substantially less. The Congressional Budget Office (CBO) estimates that FY86 deficit reduction will be $39 billion with $200 billion reduction over the three year budgeting period. Furthermore, of that $200 billion only $68 billion is reconciled, meaning that the budget resolution provides enforceable instructions to committees to make spending reductions. The other $132 billion in spending cuts must be approved by individual appropriation committees and so are unlikely to be enacted. As a result we continue to anticipate federal deficits of $200 billion or more for the next several years.

The Reagan Administration has revised down their forecast of GNP growth for 1985 to 3 percent. However, they still remain overly optimistic that the economy will grow at a 5 percent annual rate for the rest of the year. They believe most of this growth will come from a build up of inventories as well as the stimulative effects of lower interest rates on consumption spending and investment. This stronger growth in the second half is expected to push the unemployment rate down to 7 percent. They expect the slower growth this year could increase the federal deficit by $15 billion for fiscal 1985 with the total for the year reaching $192 billion.

The likehood for this scenario is extremely low. Instead, inventory investment is expected to remain stable while growth in consumer spending and investment should slow. Most analysts agree that real growth should be around 3 percent for the third quarter before declining to 2.5 percent during the fourth quarter, putting second half growth at an annual rate of 2.8 percent in contrast to the Administration's 5 percent forecast. Real output growth for all of 1985 should remain well below 3 percent, pushing the FY85 deficit well above $200 billion.

Monetary Policy and Interest Rates

In its mid-year report to Congress the Federal Reserve Board (FED) announced a significant change in its target range for M1, the narrowest definition of the nation's money supply. The target range for M1 has been broadened from 4 to 7 percent to 3 to 8 percent while the base for computing this percentage change has been moved forward from the fourth quarter of 1984 to the second quarter of 1985. Thus, the rapid growth of M1 during the first half of this year (an annual rate of about 10 1/2 percent) has been forgiven, at least for now.

Table 1

Growth Targets for Monetary Aggregates

Monetary Aggregate	1985 February	1985 July	Preliminary 1986
M1	4% to 7%	3% to 8% [1/]	4% to 7%
M2	6% to 9%	6% to 9%	6% to 9%
M3	6% to 9 1/2%	6% to 9 1/2%	6% to 9%
Domestic Nonfinancial Debt	9% to 12%	9% to 12%	8% to 11%

[1/] Annual rate of growth from the second quarter of 1985 to the fourth quarter of 1985

Some analysts have incorrectly labeled this change in the M1 target range and base as an abandonment of the inflation fight by the FED. In fact, however, this change represents a responsible adaptation to a significant increase in the demand for checkable deposits, otherwise known as a decline in M1 velocity, that is expected to be permanent. In response to the sharp decline in interest rates since mid-1984, both households and businesses have shifted funds out of savings accounts and money market funds into checkable accounts such as NOW and super-NOW accounts while increasing their overall holdings of such deposits in relation to their incomes.

The FED has accomodated the increased demand for liquidity by supplying reserves to the banking system as well as reducing the discount rate from 8 to 7 1/2 percent in late May. This, along with the slowdown of the economy, resulted in five year lows for interest rates by mid-June with the rate on 3-month Treasury bills dipping below 7 percent and the rate on 30-year Treasury bonds falling to about 10 1/4 percent. Rates have risen since then, with the sharpest increases for the longer maturities, due to investor uncertainty over the strength of the economy, FED policy, and the value of the dollar. However, as the weakness of the economy becomes more evident both short- and long-term rates should edge down again over the remainder of 1985 and into 1986. In fact, we anticipate a further easing of credit conditions by the FED later this year including another cut in the discount rate in an effort to spur the economy.

Real Estate Markets

The housing industry continues to exert a positive influence on overall economic activity. Mortgage interest rates have fallen to five year lows, boosting the NAR Affordability Index 1 full percentage point in June to 91.1 percent. In response, existing home sales remained above a seasonally-adjusted annual rate of 3.0 million units in June for the fourth month in a row while housing starts hit a 1.7 million unit annual rate. As affordability continues to improve through the remainder of 1985 and into 1986 due to lower interest rates, both existing home sales and housing starts should experience additional modest improvement with existing home sales above 3 million units for both 1985 and 1986 and total housing starts between 1.85 and 1.9 million units in both years.

Although the current levels of housing activity are a significant improvement over the dark days of 1982, they are well below the levels of 1979 when market interest rates were at levels comparable to today's. For instance, in 1979 existing home sales topped 3.9 million units compared to 3.05 million units expected for 1985 - a full 22 percent lower. The difference between 1979 and 1985 home sales lies in the difference in real (inflation adjusted) mortgage rates. Currently, real mortgage interest rates are about 9 percent, more than three times what they were in 1979. Contributing to the current high level of real mortgage rates has been the continued drain of savings out of housing required to finance the huge federal deficit. Until the federal deficit is reduced considerably, the real interest rate is expected to remain double or triple the average of the past 30 years.

Second Homes

Second home mortgage deductions would be limited under the Reagan proposal by including second home interest with other personal interest and limiting the total to $5,000, plus passive investment income, after a phase-in. The rationale for this limitation is that a second home is "extraordinary consumption" enjoyed by a relatively few, high-income households which should not be subsidized by the government.

Analysis indicates that the loss of property tax deductibility and limitations on mortgage interest would cause the after-tax cost of the typical $60,000 second home to rise from 25 to 60 percent depending on the circumstances of the taxpayer who owns or is considering the purchase of a second home. This has the potential of reducing second home property values 20 to 40 percent and depressing the economies of many second or vacation home communities which exist in nearly every state.

It is also important to note that a Federal Reserve Board survey reveals that in 1983 over 60 percent of Americans who owned second homes had incomes of $30,000 or less. In fact, it is these low- and middle-income families who are second home owners who would be adversely impacted by this provision.

Commercial Real Estate

The outlook for commercial building construction remains mixed. New office building construction is expected to continue to decline through 1986 as the office vacancy rate remains at double-digit levels. Slower overall economic activity will also dampen office building construction through 1986. New construction of retail buildings, on the other hand, is expected to remain strong through 1986 as strong growth in housing starts is expected to spur demand for nearby retail space.

Table 2

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,811	3,854	3,907	3,965	4,015	4,062	4,113	4,172	3,305	3,663	3,884	4,090	4,402
Percent Change	5.6	4.6	5.7	6.0	5.1	4.8	5.2	5.8	7.7	10.8	6.0	5.3	7.6
Percent Change (without inflation)	0.3	1.7	3.0	2.6	2.0	1.5	1.7	2.1	3.7	6.8	2.3	2.1	3.2
Consumption	5.2	5.2	2.4	1.4	2.1	1.6	1.3	1.7	4.8	5.3	3.9	2.0	2.4
Durables	9.2	8.0	3.4	-1.0	0.3	-0.5	-0.5	1.2	12.1	13.1	6.9	0.7	2.4
Nondurables	3.7	5.9	0.9	1.0	1.9	1.0	1.1	0.8	3.7	4.6	2.6	1.5	1.7
Services	5.0	3.7	3.1	2.5	3.0	2.8	2.6	2.6	3.4	3.2	3.8	2.8	2.9
Residential Investment	5.5	14.0	11.2	11.8	3.7	-2.3	0.4	2.8	41.7	12.2	4.3	5.0	0.0
Nonresidential Investment	-1.5	13.6	4.3	-0.9	3.0	1.0	5.0	6.6	2.5	19.8	7.0	3.1	6.2
Structures	9.5	19.2	7.1	-3.1	-1.8	-2.3	0.9	3.9	-7.8	15.6	11.2	0.8	4.3
Equipment	-5.6	11.4	3.4	-0.1	5.0	2.4	6.7	7.6	7.3	21.5	5.4	4.1	6.9
Exports	-8.9	-12.5	4.1	11.0	12.3	12.2	11.5	11.6	-5.6	4.7	-2.9	9.2	9.2
Imports	32.2	1.4	11.0	8.4	1.1	-2.8	-2.4	-0.7	7.6	17.0	9.1	2.3	1.8
Government Purchases	0.3	3.9	3.3	0.3	0.8	0.7	0.1	-0.3	-0.3	3.5	4.1	1.0	2.1
Consumption (% of GNP)	65.5	66.0	65.9	65.7	65.7	65.8	65.7	65.7	65.8	64.8	65.8	65.7	65.2
Residential Investment (% of GNP)	3.6	3.7	3.8	3.9	3.9	3.8	3.8	3.8	3.5	3.7	3.7	3.8	3.7
Nonresidential Investment (% of GNP)	12.8	13.2	13.2	13.1	13.1	13.1	13.2	13.4	11.1	12.5	13.1	13.2	13.6
Structures (% of GNP)	3.7	3.8	3.8	3.8	3.7	3.7	3.7	3.7	3.2	3.5	3.8	3.7	3.8
Equipment (% of GNP)	9.1	9.4	9.4	9.3	9.4	9.4	9.5	9.6	7.9	9.0	9.3	9.5	9.8
Inventory Change ($ billions)	40.7	12.6	19.9	33.9	23.7	12.8	-0.5	-12.0	-13.5	58.2	26.8	6.0	-3.2
Mfg. Capacity Utilization Rate (%)	81	80	80	80	79	79	79	79	74	81	80	79	80
Auto Sales (millions of units)	10.8	10.9	10.9	10.7	10.6	10.4	10.4	10.4	9.2	10.4	10.8	10.5	10.6
Domestic (% of total)	78.0	75.5	71.2	71.0	72.3	70.9	67.8	65.9	74.0	76.5	73.9	69.2	66.1
Imported (% of total)	22.0	24.5	28.8	29.0	27.7	29.1	32.2	34.1	26.0	23.5	26.1	30.8	33.9
Manufacturing Industrial Production (% change)	1.1	2.6	1.9	2.6	2.6	2.2	2.7	4.3	7.8	11.2	2.2	2.5	5.5
Common Market	0.8	6.2	3.2	2.1	2.1	2.2	1.4	2.7	0.9	3.2	2.8	2.4	1.3
Japan	-1.8	5.3	7.3	6.7	11.1	6.3	4.2	2.4	3.5	11.0	5.2	7.1	1.3
Trade Deficit	120	128	143	151	148	143	139	135	41	102	135	141	133
Value of the U.S. Dollar (Weighted by Trade)	1.350	1.313	1.229	1.187	1.143	1.114	1.085	1.068	1.142	1.224	1.270	1.102	1.069
Percent Change - Year Ago	15.2	10.5	-1.7	-7.5	-15.3	-15.1	-11.7	-10.0	4.0	7.2	3.8	-13.2	-3.1
Employment(millions)(civilian:household basis)	106.7	106.8	107.1	107.7	108.0	108.4	108.7	109.0	100.8	105.0	107.1	108.5	110.3
Percent Change	3.0	0.1	1.5	2.0	1.2	1.4	1.1	1.3	1.3	4.1	2.0	1.4	1.7
Unemployment Rate (%) (civilian)	7.3	7.3	7.3	7.4	7.4	7.5	7.7	7.8	9.6	7.5	7.3	7.6	7.8
Personal Income per Household (average)<1>	40,078	40,468	40,926	41,421	41,962	42,452	42,943	43,439	35,416	38,527	40,723	42,699	45,299
Percent Change -- Year Ago (w/o inflation)	3.5	2.3	1.8	1.3	1.1	1.2	1.1	0.9	1.5	5.4	2.2	1.1	1.8
Personal Taxes per Household (average)	7,740	7,236	7,623	7,728	7,832	7,943	8,056	8,174	6,478	6,956	7,582	8,001	8,572
Percent Change -- Year Ago (w/o inflation)	10.6	1.2	4.9	4.2	-1.7	6.5	2.4	2.4	-3.0	3.5	5.2	2.3	2.7
Percent of Personal Income	20.2	18.7	19.5	19.5	19.6	19.6	19.6	19.7	19.1	18.8	19.5	19.6	19.8
Disposable Income per Household (average)	32,338	33,233	33,303	33,693	34,130	34,509	34,887	35,265	28,938	31,571	33,142	34,698	36,727
Percent Change--Year Ago (w/o inflation)	2.0	2.7	1.4	1.0	2.1	0.2	1.0	0.8	2.5	5.7	1.8	1.0	1.6
Household Debt (% of total)	23.1	23.2	23.8	24.1	24.2	24.2	24.3	24.2	19.7	21.2	23.6	24.2	23.6
Household Interest Payments (% of total)	10.3	10.4	10.9	10.9	10.8	10.8	10.7	10.2	9.7	10.4	10.6	10.6	9.9
Consumer Price Inflation (CPI)	3.3	4.2	2.8	3.6	3.4	3.5	3.8	3.9	3.2	4.3	3.5	3.5	4.1
Gross National Product Inflation (GNP Deflator)	5.4	2.8	2.6	3.3	3.1	3.3	3.4	3.6	3.8	3.8	3.6	3.2	4.3
Personal Consumption Inflation	3.3	3.1	3.3	3.7	3.6	3.8	4.0	4.0	3.7	3.2	3.2	3.7	4.1
Residential Construction Inflation	-0.6	-2.2	3.1	3.9	4.7	4.9	4.9	5.1	1.7	3.9	1.4	4.0	5.1
Nonresidential Construction Inflation	3.4	3.0	2.8	3.6	4.5	4.3	4.4	4.5	-1.0	0.3	2.5	4.0	4.6
Producers Price Inflation (WPI)	-2.2	0.4	0.4	2.5	2.1	2.1	2.8	3.3	1.3	2.4	-0.1	2.0	3.4
Compensation per Manhour (% change)	5.5	4.0	3.9	4.2	5.0	4.0	4.4	4.7	4.8	4.2	4.2	4.4	5.2
Productivity (% change)	-2.6	0.4	1.3	1.8	1.1	0.6	0.7	1.0	3.4	2.7	0.3	1.1	1.8
Unit Labor Cost (% change)	8.2	2.7	3.4	2.3	3.9	3.4	3.7	3.7	1.3	1.4	3.8	3.3	3.3
Before Tax Corporate Profits ($ billions)<2>	229	220	218	220	222	222	223	228	213	243	221	224	265
Corporate Tax Liability	92	83	81	81	83	82	81	83	86	98	84	82	104
After Tax Profits	137	136	137	138	139	140	142	145	127	146	137	142	161
Inventory Valuation Adjustment	1	0	-6	-12	-14	-14	-16	-18	-11	-6	-4	-15	-20
Capital Consumption Adjustment	69	76	82	88	87	85	82	82	33	56	79	84	76
Profits from Current Production (with IVA, CCA)	207	213	213	213	213	211	209	209	149	196	211	210	217
Adjusted for Inflation (85:1 base)	207	211	210	209	207	203	199	198	159	201	209	202	200
Percent Change - Year Ago	7.9	5.1	3.0	1.1	-0.1	-3.8	-5.0	-5.4	46.0	26.5	4.2	-3.6	-1.0
Per Unit of Output (% of GNP)	5.4	5.5	5.4	5.4	5.3	5.2	5.1	5.0	4.5	5.3	5.4	5.1	4.9
Effective Corporate Tax Rate (%)<2>	30	27	27	27	27	27	27	28	34	32	27	27	32
Federal Tax Receipts (Unified basis)	696	809	737	674	663	908	746	708	613	683	729	756	827
Percent of GNP	18.3	21.0	18.9	17.0	16.5	22.3	18.1	17.0	18.6	18.7	18.8	18.5	18.8
Federal Expenditures (Unified basis)	919	935	927	978	970	974	952	1,013	803	868	940	977	1,047
Percent of GNP	24.1	24.3	23.7	24.7	24.2	24.0	23.2	24.3	24.3	23.7	24.2	23.9	23.8
Surplus or Deficit (Unified basis)	-223	-125	-190	-303	-307	-66	-206	-305	-190	-184	-210	-200	-205
% of GNP	5.8	3.3	4.9	7.6	7.6	1.6	5.0	7.3	5.8	5.0	5.4	4.9	4.7
% of Personal Savings	187.8	86.7	160.4	245.4	237.6	50.1	154.3	228.3	158.1	117.2	170.1	151.6	135.0
% of Net Domestic Savings	75.5	38.7	64.1	101.7	102.8	22.3	70.3	105.4	80.0	56.5	70.0	68.1	63.9

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 3

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	4,057	4,092	4,282	4,289	4,246	4,246	4,248	4,254	3,750	3,936	4,180	4,249	4,086
Percent Change -- Year Ago	-1.9	0.8	15.0	12.1	4.7	3.8	-0.8	-0.8	42.4	5.0	6.2	1.6	-3.8
Existing Single-Family Home Sales (thousands)	2,970	3,050	3,085	3,095	3,095	3,099	3,101	3,105	2,716	2,866	3,050	3,100	2,990
Percent Change - Year Ago	1.9	2.6	11.7	10.0	4.2	1.6	0.5	0.3	36.5	5.5	6.4	1.6	-3.5
Dollar Volume (billions)	261.3	276.0	278.1	271.8	276.9	281.8	282.9	276.9	224.2	247.1	271.8	279.6	277.7
Existing Home Prices - Median ($1000's)	73.8	75.3	75.9	74.6	76.6	78.3	78.9	77.4	69.8	72.3	74.9	77.8	81.1
Percent Change - Year Ago	3.6	3.6	3.7	3.6	3.7	3.9	3.9	3.8	3.2	3.5	3.6	3.8	4.2
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	657	655	634	618	625	630	620	599	628	680	641	618	662
Percent of Median Family Income	30	29	28	27	27	27	26	25	32	32	29	26	27
Private Housing Starts (thousands)	1,795	1,770	1,953	1,959	1,884	1,889	1,897	1,910	1,703	1,766	1,869	1,895	1,840
Percent Change - Year Ago	-7.8	-4.7	17.4	22.6	4.9	6.7	-2.8	-2.5	61.0	3.8	5.8	1.4	-2.9
Single-Family	1,121	1,074	1,234	1,231	1,187	1,183	1,182	1,184	1,066	1,103	1,165	1,184	1,130
Percent of Total	62.5	60.7	63.2	62.8	63.0	62.6	62.3	62.0	62.6	62.4	62.3	62.5	61.4
Multi-Family	674	696	718	728	697	706	716	725	637	664	704	711	710
Percent of Total	37.5	39.3	36.8	37.2	37.0	37.4	37.7	38.0	37.4	37.6	37.7	37.5	38.6
Mobile Home Shipments	277	287	296	300	298	300	300	299	296	295	290	299	293
New Single-Family Home Sales (thousands)	669	657	665	640	661	674	702	711	628	639	658	687	645
Percent Change - Year Ago	-3.3	3.8	8.2	3.6	-1.3	2.5	5.6	11.2	50.5	1.8	2.9	4.4	-6.1
New Home Prices - Median ($1000's)	83.0	84.1	84.9	85.8	87.3	88.8	90.4	92.1	75.5	80.0	84.5	89.6	95.0
Percent Change - Year Ago	6.5	4.4	4.4	6.9	5.2	5.6	6.5	7.2	8.9	6.0	5.5	6.1	6.0
New Home Prices--Mean ($1000's, Quality Adjusted)	95.2	95.6	95.4	96.2	97.4	99.6	99.7	100.9	89.7	93.7	95.6	99.4	104.5
Percent Change - Year Ago	4.6	2.4	0.3	1.0	2.3	4.1	4.6	4.9	2.1	4.5	2.0	4.0	5.1
NAR Affordability Index	88.4	90.5	92.1	94.4	94.1	94.2	96.1	100.5	82.0	86.2	91.3	96.2	97.3
Mortgage Debt Outstanding ($ billions)	2,077	2,613	2,912	3,166	3,382	3,573	3,746	3,906	1,755	1,956	2,692	3,652	4,260
Homeowners' Equity ($ billions)	2,253	2,234	2,242	2,258	2,280	2,302	2,324	2,348	2,242	2,278	2,247	2,314	2,424
Housing Inventory (millions)	95.3	95.7	96.1	96.6	97.0	97.4	97.9	98.3	92.7	94.4	95.9	97.7	99.3
Rental Vacancy Rate (%)	6.3	6.0	5.9	5.8	5.8	5.8	5.9	5.9	5.6	5.9	6.0	5.8	5.9
Office Vacancy Rate (%)<1>	15.4	16.1	15.3	15.0	14.5	14.3	14.1	14.0	11.7	13.9	15.5	14.2	13.6
Industrial Vacancy Rate (%)<1>	4.0	4.9	4.5	4.5	4.3	4.2	4.0	3.9	4.9	4.7	4.5	4.1	3.5
New Commercial Building Construction (% Ch Value)	52.6	18.6	-4.8	0.1	-0.7	1.3	3.0	4.1	-4.2	33.7	26.6	1.2	7.4
New Industrial Building Construction (% Ch Value)	21.6	72.5	-32.0	2.2	-0.8	3.9	7.4	13.5	-25.7	5.9	17.6	1.1	16.0
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	10.9	10.6	5.3	6.0	5.4	5.4	5.8	5.4	11.2	6.9	7.3	5.9	5.6
M1 Velocity (% change)	-4.8	-5.4	0.4	0.0	-0.3	-0.6	-0.6	0.4	-3.2	3.7	-1.2	-0.5	1.9
M2 (% change)(FED Target 6-9%)	12.6	5.4	9.2	6.5	6.7	6.5	6.9	7.0	12.5	7.9	8.8	6.9	7.2
M2 Velocity (% change)	-6.2	-0.8	-3.2	-0.5	-1.4	-1.6	-1.6	-1.1	-4.4	2.7	-2.5	-1.5	0.4
Monetary Base (% change)	6.8	9.3	7.0	6.2	5.1	4.7	4.8	5.0	9.5	8.1	7.0	5.7	5.1
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	671	657	672	681	696	700	701	707	478	653	672	698	749
Private													
Personal Savings	119	145	118	124	129	132	133	134	118	156	126	132	151
Savings Rate	4.5	5.3	4.3	4.4	4.6	4.6	4.6	4.5	5.0	6.1	4.6	4.6	4.9
Gross Business Saving	544	554	559	565	570	578	582	588	454	519	555	579	615
Government													
Federal	-165	-222	-201	-202	-197	-198	-199	-193	-179	-176	-197	-200	-203
State and Local	54	52	52	50	47	46	46	44	44	53	52	46	53
Foreign (current account deficit)	120	128	143	151	148	143	139	135	41	102	135	141	133
Uses (total:gross investment)	647	639	659	681	682	679	678	683	472	638	657	681	732
Nonresidential Investment													
Equipment	288	295	299	300	307	312	321	330	223	275	296	317	352
Structures	163	172	176	176	177	178	180	184	130	150	171	180	196
Residential Investment	155	160	165	171	175	176	178	181	132	154	163	178	186
Inventory Investment	41	13	20	34	24	13	-1	-12	-13	58	27	6	-3
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	13.7	13.4	12.8	12.7	12.5	12.3	12.0	11.8	13.8	14.5	13.1	12.2	12.5
Real Mortgage Rate (30 yr. avg. is 4.5%)	8.3	10.6	10.2	9.4	9.4	9.0	8.6	8.2	10.1	10.9	9.6	8.8	7.7
1 Year ARM (without buy-down)	11.1	10.2	10.0	10.2	10.2	9.8	9.8	9.9	11.3	12.6	10.4	9.9	10.5
Real Mortgage Rate	5.7	7.4	7.4	7.0	7.1	6.6	6.4	6.3	7.5	9.0	6.9	6.6	5.7
Corporate Bond Rate (AAA)	12.3	11.6	10.9	10.7	10.3	10.2	9.9	9.9	12.0	12.7	11.4	10.1	10.5
Government Bond Rate	11.8	11.1	10.7	10.5	9.9	9.7	9.4	9.4	11.3	12.5	11.0	9.6	10.0
Real Government Bond Rate (30 yr. avg. is 2.1%)	6.4	8.4	8.1	7.2	6.8	6.4	6.0	5.8	7.6	8.9	7.5	6.3	5.2
Federal Funds Rate	8.5	7.9	7.8	7.7	7.6	7.4	7.3	7.5	9.1	10.2	8.0	7.5	8.5
3 Month Treasury Bill Rate	8.2	7.5	7.2	7.4	7.4	7.0	7.0	7.1	8.6	9.5	7.5	7.1	7.7
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	2.8	4.7	4.5	4.1	4.3	3.7	3.6	3.5	4.8	5.9	4.0	3.8	3.0
1 Year Treasury Bill Rate	9.4	8.5	8.3	8.5	8.5	8.1	8.1	8.2	9.6	10.9	8.7	8.2	8.8
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	4.0	5.7	5.7	5.3	5.4	4.9	4.7	4.6	5.8	7.3	5.2	4.9	4.0
Commercial Paper Rate	8.5	7.9	7.5	7.7	7.6	7.4	7.3	7.5	8.9	10.1	7.9	7.5	8.4
Rate on Money Market Fund Shares	8.6	7.9	7.6	7.8	7.7	7.5	7.4	7.6	9.0	10.3	8.0	7.6	8.5
Prime Rate	10.5	10.2	9.4	9.3	9.2	9.1	8.7	9.0	10.8	12.0	9.9	9.0	10.0

<1> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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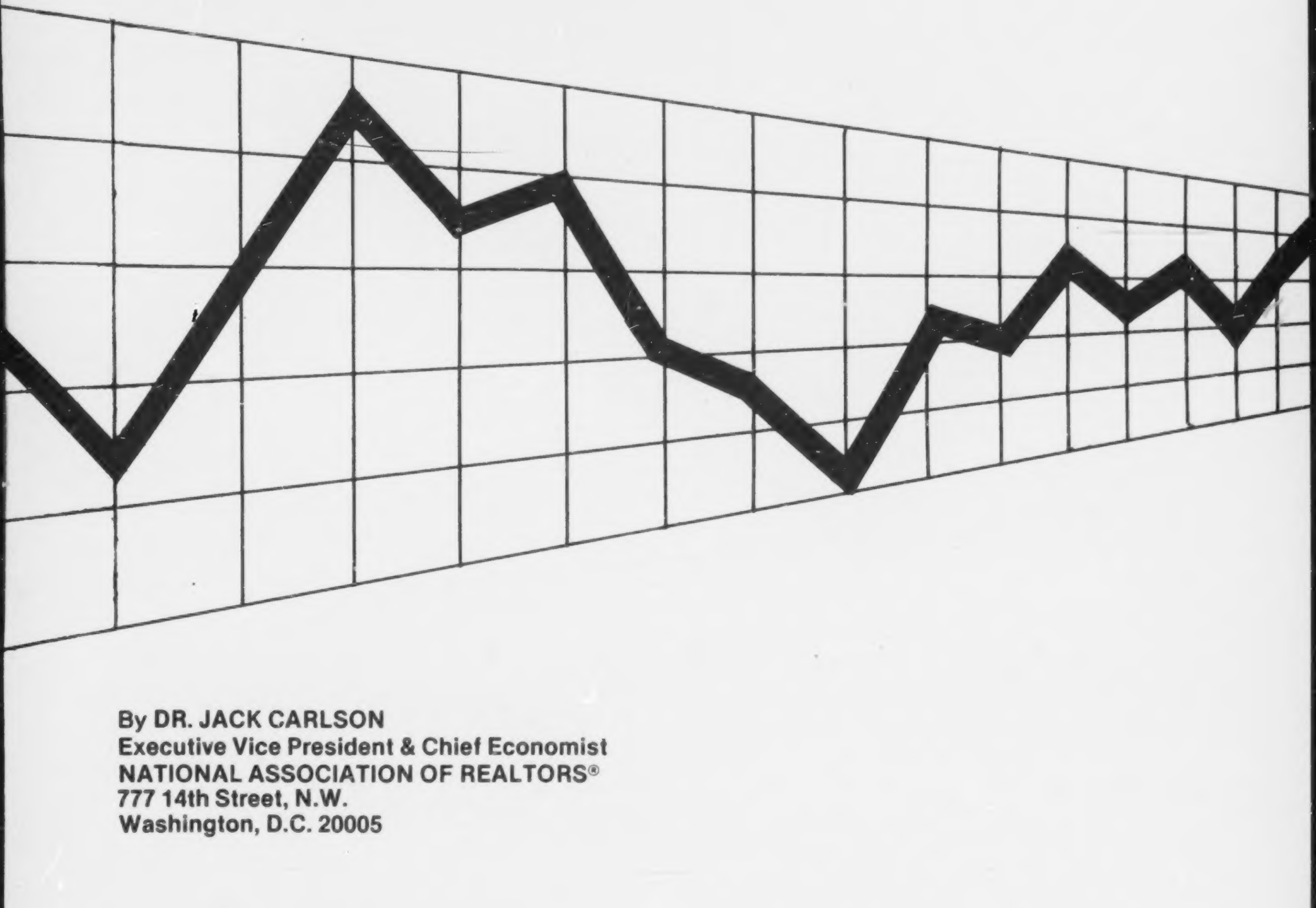
OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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SEPTEMBER 1985

Outlook For the Economy and Real Estate

Aggregate Economy

With real economic activity increasing at an anemic rate of 1.1 percent for the first half of 1985, the expansion of the last 2-1/2 years is clearly running out of steam. Real output, after increasing 2.0 percent during the second quarter, is expected to increase a modest 2.5 percent in the third quarter as inventory investment stabilizes and lower interest rates provide some stimulus to the interest-sensitive industries - especially housing. However, the economy is not likely to experience the strength of the magnitude predicted by the Administration for the second half of this year, largely because high real (inflation-adjusted) interest rates and anticipation about possible tax revisions are providing disincentives to private investment.

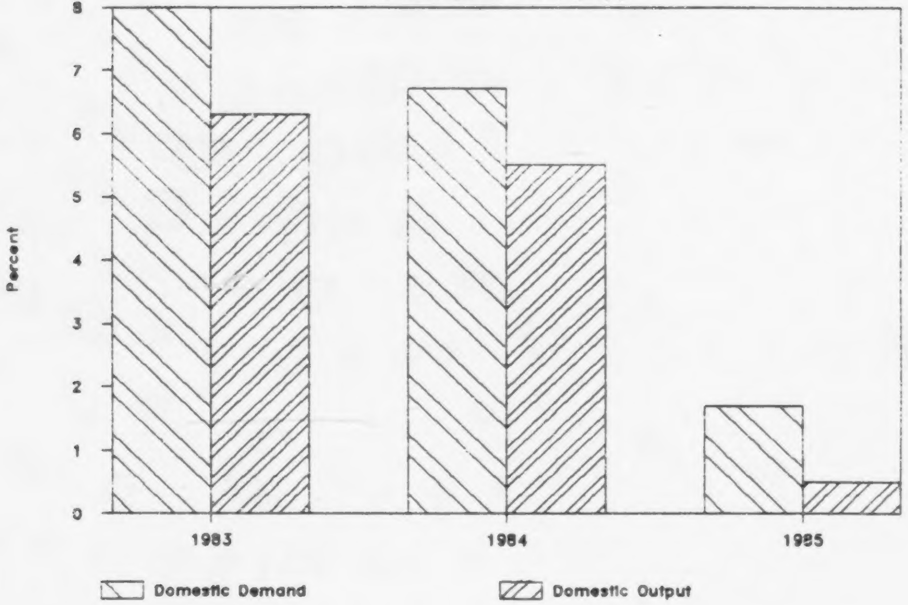
This rebound in economic activity is likely to be both modest and short-lived. The monthly data for July suggests a slow start as retail sales, consumer spending and personal income all remain weak. In addition, a low savings rate accompanied by the continuation of high levels of consumer debt will lead to lower consumption during the second half of 1985 as consumers attempt to reduce their debt burdens, which presently comprises 18 percent of disposable income. By 1986, the overvalued dollar will continue to boost imports while depressing exports pushing real output growth well below 2 percent for the first three quarters of 1986. By the end of 1986 and through 1987, the dollar should have depreciated by then allowing domestic producers to once again compete in both domestic and international markets, reviving economic growth.

Concern has arisen in the financial markets that the rapid growth of M1 we are presently experiencing will reignite inflationary pressures. However, the accompanying sluggishness of real output despite the strong growth in the money supply is an indication that this will not occur. Currently, domestic demand, which measures spending, far exceeds growth in output, reflecting the continued domination of imports in domestic markets. Historically, when the growth in demand or spending is matched by an increase in output, an increase in capacity utilization and a fall in the unemployment rate occurs. Both of these put upward pressure on prices as profits of domestic producers increase and wages rise. However, a large portion of the domestic demand we are currently experiencing has been for imported goods. It has not lead to any substantial increase in domestic output. (See Figure 1) Subsequently, no such profit, wage and therefore, price pressures should occur in the domestic market. The recent stagnation in both the capacity utilization rate and the unemployment rate underscores this fact.

Figure 1

Growth of Demand vs. Output

Fourth qtr. to Fourth qtr.(1)



(1)1985 based on second qtr. data

Employment and Inflation

The civilian unemployment rate remained unchanged at 7.3 percent in July for the sixth month in a row, further underscoring the slowing in overall economic activity. There was good news, however, in the July employment figures, as overall employment increased 243,000 jobs indicating a modest rebound in the third quarter. In fact, even manufacturing employment, which has been on the decline for the past two months, increased slightly in July; an indication that the manufacturing sector may enjoy some of the prosperity of the service sector.

Inflation should remain well under control through 1986 despite the sharp drop in the value of the dollar in foreign trade during the past month. Contributing to a lower inflation rate will be the continued slack in the economy which should keep wage increases moderate. In addition, domestic firms, eager to regain some of the market share they lost to imports during the dramatic appreciation of the dollar, will continue to exhibit restraint in pricing. Finally, falling energy prices and weak food prices will keep overall prices down with Consumer Price Inflation (CPI) expected to increase at a 3.5 percent rate in 1985 and a 3.3 percent rate in 1986. By 1987, though, stronger growth will lead to a modest increase in prices pushing CPI to 3.9 percent.

Monetary Policy and Interest Rates

Both short- and long-term interest rates are expected to trend downward slowly through 1986 as overall demand for credit remains fairly weak reflecting the overall slowing in economic activity. Evidence of weak short-term credit demands has been the recent declines in commercial and industrial loans. However, the decline in interest rates will not be as steep as previously expected as the outflow of foreign capital resulting from the dollar's recent decline and the still enormous federal deficit reduce the overall supply of funds available for borrowing.

Real Estate Markets

The nation's housing markets likely will continue as one of the economy's few bright spots this year and next as most other sectors experience a slowdown. The home resale market is likely to have its best year since 1979 this year with existing single-family home sales expected to total 3.06 million units. An even better year is expected in 1986, with 3.12 million home resales expected, as lower interest rates enable a growing number of families to make the housing purchases they put off in 1981-1983 when interest rates were higher. This volume of resales are adding about $62 billion to the nation's income or about 2 percent of GNP as people prepare houses for sale and fix up homes after purchase and transfer. These add to the demand for goods and services about $20,000 for each affected home.

Home prices are expected to accelerate modestly this year and into 1986, with new-home prices rising faster than existing-home prices. While the median existing single-family home price is likely to increase 3.5 percent this year to $74,800 and 3.6 percent next year to $77,500, the median new-home price is expected to rise 5.2 percent this year to $84,200 and 6.3 percent next year to $89,500.

The economy's lapse into a "growth recession" is taking its toll on contracts for commercial and industrial buildings. After increasing a strong 11% during the first half of 1984, contracting advanced a modest 6 percent through the last half of 1984. Further, contracting for commercial and industrial building virtually ceased altogether during the first 6 months of 1985, increasing a mere 1 percent. The outlook for the remainder of 1985 does not look favorable as contracting for commercial and industrial building is expected to decline by 3 percent in the second half of 1985. Part of the fall off so far in 1985 and the forecast for the remainder of 1985 and 1986 reflects fear of anti-investment tax increases on structures that could lower the value of any new construction by 10 to 20 percent.

Among commercial and industrial buildings, contracts for office building construction will be the most hard-hit. Although office construction experienced strong growth during the first half of 1985, despite a vacancy rate well above 15 percent, most of the gains are short-lived and selective and occurred in the part to a response to grandfathering existing depreciation allowances. This trend is not expected to continue as supply continues to outstrip demand, pushing the rate of contracting down to 285 million square feet in the second half of 1985. By 1986, contracts for new office construction is expected to decline 10 percent to 265 million square feet.

The one bright spot in nonresidential construction has been contracting for stores, shopping centers, and warehouses, which have benefited from increased construction of housing. This area is expected to experience strong growth through the remainder of 1985 and modest growth during 1986 as lower interest rates continue to stimulate housing demand.

Table 1

Commercial and Industrial Building Contracts

	Stores and Other Commercial		Office Buildings		Industrial Buildings	
Year	millions of sq ft	percent change	millions of sq ft	percent change	millions of sq ft	percent change
1981	337	-11%	325	+15%	187	-13%
1982	245	-27%	261	-20%	118	-37%
1983	362	+48%	281	+ 8%	107	-37%
1984	478	+32%	318	+13%	144	+33%
1985^f	531	+11%	295	- 7%	142	- 1%
1986^f	550	+4%	265	-10%	140	- 1%

f: forecast

Source: Historical Data: DRI, Review of the U.S. Economy, August 1985.
Forecasts: NATIONAL ASSOCIATION OF REALTORS®

Special Supplement
The Effects of Federal Deficits

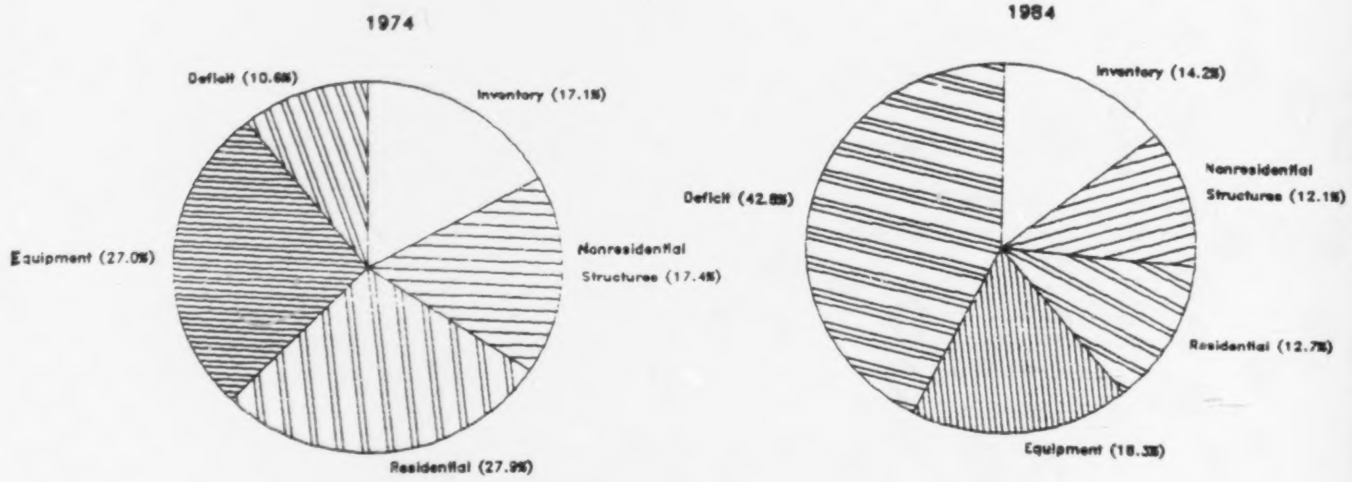
The continued existence of large federal deficits adversely affects economic growth. They increase total demand for savings reducing the share available for investment (current crowding out), causing long-term interest rates to be much higher than they otherwise would be. They cause a more restrictive monetary policy than otherwise would be, pushing short-term interest rates higher as the Federal Reserve (FED) attempts to offset the increased stimulation of government spending that exists while revenues remain unchanged. Finally, large federal deficits increase fears of future inflation.

The deficit "crowds out" the private sector from the capital markets weakening long-term growth. In 1984, the goverment deficit in the U.S. was taking nearly 50 percent of net domestic savings. Consequently, real (inflation- adjusted) long term interest rates in the U.S. were significantly higher when compared with other major industrial countries.

Because deficits have caused high real interest rates to increase at unprecedented rates since 1980, investment in people (education and training), in structures (residential, commercial, industrial and agricultural), in long-life equipment and in homeownership has suffered (Figure 2), leaving overall investment in these areas well below the needs of an expanding economy.

Figure 2

% of Net Domestic Investment



Deficit-induced high interest rates have severe effects on homeownership. The Census Bureau has reported an alarming trend - the rate of homeownership in the U.S. has been on the decline. In 1980, 65.8 percent of the nation's households owned their home, but that figure stood at only 64.7 percent in 1984. If the trend of the early 1980's were to continue by the year 2000, the homeownership rate could be below 60 percent instead of about 72 percent. Since each one-tenth of a percentage point decline in the homeownership rate represents about 85,000 fewer homeowners nationwide, this would translate into 10 million fewer homeowners than there would otherwise be. In as much as the discipline of homeownership leads to greater savings not only for housing but up to 20 percent of the needs of industry, we can expect $50 billion less savings and thus a greater shortage of investable funds to keep the economy growing.

High U.S. interest rates, caused in large measures by the huge federal deficit, attracts foreign capital which helps to finance this deficit. But this offset is incomplete and is at a high cost. The inflow of foreign funds to partially substitute for funds taken to finance the deficit has increased the exchange value of the dollar by over 20 percent. This acts as a tax on U.S. export industries, reducing the quantity of American-made products and services sold abroad. Similarly, it acts like a subsidy on foreign made products and services coming into the U.S., damaging U.S. industries which must compete with imports and inhibiting investment in new and promising businesses.

Because of high federal deficits, we have experienced record balance of payment deficits with resulting declines in American jobs. According to the U.S. Department of Commerce, the 18.9 percent drop in U.S. export volume between 1980 and 1983 has already produced a huge loss of 1.5 million jobs. The Commerce Department has estimated that an average of 25,000 jobs are lost for each one billion dollar decline in export volume. Thus, under current budget deficit projections and the resulting high real interest rates deficits cause, the projected shortfall in export volume of $100 billion will cause a loss of 2.5 million full-time jobs through 1985 and 1986.

The deficit is projected to be over $200 billion through 1987, even with the anemic deficit reduction recently enacted by congress, further withdrawing savings and investment from growth producing activity.

Further, the current level of inflow of foreign capital is assumed to decline modestly through 1987 as the dollar begins to depreciate. Therefore, the "crowding out" effect of the deficit on domestic investment will become even more critical. Without foreign capital inflow during the current recovery, the rate of investment in the United States would have been 30 to 40 percent lower in 1983 and 1984.

By official account, foreign owned assets in the United States as of the end of 1984 totaled $886.4 billion. This amount compares with $914.7 billion of U.S. assets abroad at the end of the same year. Foreign owned assets are likely to exceed U.S. owned assets abroad for the first time in 50 years by the end of 1985.

Table 2
Source of Funds by Area of Origin

	Amount	% of Market
Western Europe	$419.5	47.3
Canada	$57.0	6.4
Japan	$64.1	7.2
Latin America and Other Western Hemisphere Countries	$189.4	21.4

For real estate specifically, the U.S. Department of Commerce reported that at the end of 1984, the stock of foreign direct investment in this area amounted to $16.9 billion. For the same year alone, net capital inflow from this source was $2.2 billion, which is a palfrey 2.3% of net foreign capital inflow. More than one fourth of U.S. savings go into housing and other real estate.

The increasing relative importance of foreign funds to the functioning of the U.S. economy can be better gleaned from looking at the amount that the U.S. had to raise from the international capital market. In 1984, the U.S. raised $65.1 billion or almost 28 percent of bond issues and bank credits in the international capital market. This is a dramatic jump from only about 12 percent of the same total in 1982.

Table 3

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,811	3,855	3,905	3,959	4,013	4,061	4,113	4,176	3,305	3,663	3,882	4,091	4,394
Percent Change	5.6	4.8	5.3	5.6	5.6	4.9	5.3	6.3	7.7	10.8	6.0	5.4	7.4
Percent Change (without inflation)	0.3	2.0	2.5	2.3	1.7	1.4	1.8	2.5	3.7	6.8	2.3	1.9	3.3
Consumption	5.2	5.3	2.1	3.4	1.4	1.1	1.1	1.5	4.8	5.3	4.0	2.0	2.2
Durables	9.2	7.4	-1.7	9.2	-1.9	-2.5	-1.3	0.2	12.1	13.1	6.8	0.8	1.6
Nondurables	3.7	5.1	1.4	1.6	1.9	0.6	0.7	0.6	3.7	4.6	2.5	1.5	1.6
Services	5.0	4.8	4.0	2.8	2.2	2.9	2.3	2.6	3.4	3.2	4.2	2.9	2.9
Residential Investment	5.5	5.4	8.9	14.9	10.3	2.4	2.3	3.1	41.7	12.2	2.7	7.6	0.4
Nonresidential Investment	-1.5	11.8	1.5	3.3	-1.7	-2.9	0.1	2.5	2.5	19.8	6.6	0.7	4.5
Structures	9.5	8.4	5.9	-2.1	-2.5	-3.7	0.0	1.6	-7.8	15.6	9.1	-0.4	2.2
Equipment	-5.6	13.2	-0.2	5.6	-1.5	-2.5	0.2	2.9	7.3	21.5	5.6	1.1	5.4
Exports	-8.9	-13.0	2.9	6.2	5.9	11.8	12.9	12.8	-5.6	4.7	-3.4	6.7	12.1
Imports	32.2	0.0	12.3	7.0	-1.0	-0.2	-1.2	-0.1	7.6	27.0	8.9	2.3	1.5
Government Purchases	0.3	3.7	-0.9	14.5	-6.7	0.6	-0.3	0.9	-0.3	3.5	4.3	1.0	2.2
Consumption (% of GNP)	65.5	66.0	65.9	66.1	66.1	66.0	65.9	65.7	65.8	64.8	65.9	65.9	65.2
Residential Investment (% of GNP)	3.6	3.6	3.7	3.8	3.9	3.9	3.9	3.9	3.5	3.7	3.7	3.9	3.8
Nonresidential Investment (% of GNP)	12.8	13.1	13.1	13.1	13.0	12.8	12.8	12.8	11.1	12.5	13.0	12.9	13.0
Structures (% of GNP)	3.7	3.7	3.7	3.7	3.7	3.6	3.6	3.6	3.2	3.5	3.7	3.6	3.6
Equipment (% of GNP)	9.1	9.4	9.3	9.4	9.3	9.2	9.2	9.2	7.9	9.0	9.3	9.2	9.4
Inventory Change ($ billions)	40.7	18.1	38.8	4.9	19.2	18.4	16.2	14.7	-13.5	58.2	25.6	17.1	15.9
Mfg. Capacity Utilization Rate (%)	81	80	80	80	79	78	78	78	74	81	80	78	80
Auto Sales (millions of units)	10.8	10.9	10.4	11.1	10.9	10.7	10.5	10.5	9.2	10.4	10.8	10.6	10.5
Domestic (% of total)	78.0	75.5	73.1	70.4	71.4	69.8	68.3	66.4	74.0	76.5	74.2	69.0	65.6
Imported (% of total)	22.0	24.5	26.9	29.6	28.6	30.2	31.7	33.6	26.0	23.5	25.8	31.0	34.4
Manufacturing Industrial Production (% change)	0.9	2.3	1.8	4.4	-1.1	-0.6	1.2	2.9	7.8	11.0	2.6	1.1	5.0
Common Market	3.7	6.2	3.1	1.7	1.9	2.3	1.2	2.3	0.3	3.2	3.5	2.3	1.5
Japan	-2.6	12.6	-0.4	2.5	9.0	4.6	3.7	3.1	3.3	11.0	5.2	4.9	1.8
Trade Deficit	120	130	145	147	143	142	139	138	41	102	136	141	130
Value of the U.S. Dollar (Weighted by Trade)	1.350	1.313	1.236	1.208	1.190	1.111	1.076	1.056	1.142	1.224	1.277	1.108	1.016
Percent Change - Year Ago	15.2	10.5	-1.2	-5.8	-11.8	-15.3	-13.0	-12.6	4.0	7.2	4.3	-13.2	-8.3
Employment(millions)(civilian:household basis)	106.7	106.8	107.2	107.7	108.0	108.3	108.6	109.0	100.8	105.0	107.1	108.5	110.3
Percent Change	3.0	0.1	1.5	1.9	1.1	1.3	1.0	1.4	1.3	4.1	2.0	1.3	1.7
Unemployment Rate (%) (civilian)	7.3	7.3	7.3	7.4	7.5	7.6	7.7	7.8	9.6	7.5	7.3	7.6	7.8
Personal Income per Household (average)<1>	40,078	40,394	40,708	41,358	41,958	42,429	42,930	43,501	35,416	38,527	40,635	42,705	45,291
Percent Change -- Year Ago (w/o inflation)	3.5	2.1	1.4	1.4	1.3	1.4	1.5	1.0	1.5	5.4	2.1	1.3	1.8
Personal Taxes per Household (average)	7,740	7,248	7,535	7,689	7,810	7,916	8,038	8,175	6,478	6,956	7,553	7,985	8,543
Percent Change -- Year Ago (w/o inflation)	10.6	1.4	3.7	3.7	-2.1	5.8	3.1	2.7	-3.0	3.5	4.8	2.3	2.9
Percent of Personal Income	20.2	18.8	19.4	19.5	19.5	19.6	19.5	19.7	19.1	18.8	19.5	19.6	19.8
Disposable Income per Household (average)	32,338	33,146	33,174	33,670	34,148	34,513	34,892	35,326	28,938	31,571	33,082	34,720	36,748
Percent Change--Year Ago (w/o inflation)	2.0	2.4	1.1	1.2	2.3	0.6	1.4	0.8	2.5	5.7	1.7	1.3	1.6
Household Debt (% of total)	23.1	23.5	24.3	24.5	24.6	24.7	24.7	24.7	19.7	21.2	23.8	24.7	24.0
Household Interest Payments (% of total)	10.3	10.5	10.9	10.9	10.8	10.8	10.6	10.1	9.7	10.4	10.6	10.6	9.8
Consumer Price Inflation (CPI)	3.3	4.2	2.3	3.3	3.3	3.4	3.5	3.7	3.2	4.3	3.5	3.3	3.9
Gross National Product Inflation (GNP Deflator)	5.4	2.7	2.7	3.2	3.8	3.4	3.4	3.6	3.8	3.8	3.6	3.4	3.9
Personal Consumption Inflation	3.3	3.2	2.7	3.1	3.9	4.1	4.0	4.3	3.7	3.2	3.1	3.6	4.2
Residential Construction Inflation	-0.6	2.6	3.1	3.3	4.7	4.8	5.0	5.2	1.7	3.9	2.3	4.2	5.3
Nonresidential Construction Inflation	3.4	5.2	3.4	3.2	3.6	3.8	3.7	4.3	-1.0	0.3	3.0	3.7	4.2
Producers Price Inflation (WPI)	-2.3	0.3	-1.2	1.9	1.7	1.8	1.5	2.9	1.3	2.4	-0.4	1.4	2.9
Compensation per Manhour (% change)	5.0	3.5	2.4	3.9	5.3	4.6	4.8	5.1	4.8	4.2	3.8	4.3	5.2
Productivity (% change)	-3.3	0.8	1.2	1.0	0.7	0.4	0.9	1.6	3.4	2.7	0.1	0.9	1.8
Unit Labor Cost (% change)	8.5	3.0	0.9	2.8	4.6	4.1	3.8	3.4	1.3	1.4	3.7	3.4	3.3
Before Tax Corporate Profits ($ billions)<2>	229	227	220	215	224	231	233	246	213	243	222	233	279
Corporate Tax Liability	92	90	83	80	86	88	89	95	86	98	86	89	113
After Tax Profits	137	137	137	135	138	143	145	151	127	146	136	144	166
Inventory Valuation Adjustment	1	2	-1	-9	-10	-12	-13	-17	-11	-6	-2	-13	-19
Capital Consumption Adjustment	69	75	80	86	86	84	81	80	33	56	77	83	71
Profits from Current Production (with IVA, CCA)	207	213	216	212	213	215	213	214	149	196	212	214	218
Adjusted for Inflation (85:1 base)	207	211	213	207	207	207	203	202	159	201	210	205	201
Percent Change - Year Ago	7.9	5.1	4.5	0.4	-0.1	-2.2	-4.7	-2.6	46.0	26.5	4.4	-2.4	-2.0
Per Unit of Output (% of GNP)	5.4	5.5	5.5	5.4	5.3	5.3	5.2	5.1	4.5	5.3	5.5	5.2	5.0
Effective Corporate Tax Rate (%)<2>	30	29	27	26	28	28	29	30	34	32	28	29	34
Federal Tax Receipts (Unified basis)	696	826	734	672	667	913	754	721	613	683	732	763	834
Percent of GNP	18.3	21.4	18.8	17.0	16.6	22.5	18.3	17.3	18.6	18.7	18.9	18.7	19.0
Federal Expenditures (Unified basis)	919	936	910	1,002	976	975	951	1,015	803	868	942	979	1,052
Percent of GNP	24.1	24.3	23.3	25.3	24.3	24.0	23.1	24.3	24.3	23.7	24.3	23.9	24.0
Surplus or Deficit (Unified basis)	-223	-110	-177	-329	-310	-62	-197	-295	-190	-184	-210	-216	-218
% of GNP	5.8	2.8	4.5	8.3	7.7	1.5	4.8	7.1	5.8	5.0	5.4	5.3	5.0
% of Personal Savings	187.8	80.6	159.8	286.0	245.5	48.3	148.9	216.0	158.1	117.2	178.5	164.7	141.6
% of Net Domestic Savings	75.5	35.0	62.2	111.8	105.2	21.0	66.7	98.4	80.0	56.5	71.2	72.8	66.2

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 4

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	4,057	4,090	4,247	4,322	4,306	4,307	4,318	4,326	3,750	3,936	4,179	4,314	4,135
Percent Change -- Year Ago	-1.9	0.8	14.1	13.0	6.1	5.3	1.7	0.1	42.4	5.0	6.2	3.2	-4.2
Existing Single-Family Home Sales (thousands)	2,970	3,047	3,110	3,113	3,115	3,119	3,120	3,126	2,716	2,866	3,060	3,120	3,000
Percent Change - Year Ago	1.9	2.5	12.5	10.7	4.9	2.4	0.3	0.4	36.5	5.5	6.8	2.0	-3.9
Dollar Volume (billions)	261.3	273.0	278.3	271.6	277.1	281.4	283.0	277.4	224.2	247.1	271.0	279.7	276.5
Existing Home Prices - Median ($1000's)	73.8	75.2	75.8	74.5	76.4	77.9	78.6	77.2	69.8	72.3	74.8	77.5	80.6
Percent Change - Year Ago	3.6	3.4	3.6	3.5	3.5	3.6	3.7	3.6	3.2	3.5	3.5	3.6	3.9
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	657	654	629	604	605	608	594	583	628	680	636	598	632
Percent of Median Family Income	30	29	28	27	26	26	25	24	32	32	28	25	25
Private Housing Starts (thousands)	1,795	1,769	1,873	1,962	1,896	1,909	1,931	1,946	1,703	1,766	1,830	1,920	1,850
Percent Change - Year Ago	-7.8	-4.8	12.6	22.7	5.6	7.9	3.1	-0.8	61.0	3.8	4.7	3.8	-3.7
Single-Family	1,121	1,076	1,172	1,247	1,227	1,225	1,235	1,236	1,066	1,103	1,134	1,231	1,170
Percent of Total	62.5	60.8	62.6	63.6	64.7	64.1	64.0	63.5	62.6	62.4	62.3	64.1	63.3
Multi-Family	674	693	701	715	668	685	696	709	637	664	696	690	679
Percent of Total	37.5	39.2	37.4	36.4	35.3	35.9	36.0	36.5	37.4	37.6	37.7	35.9	36.7
Mobile Home Shipments	277	281	293	296	292	293	293	293	296	295	287	293	286
New Single-Family Home Sales (thousands)	669	657	661	668	674	680	685	702	629	637	664	685	650
Percent Change - Year Ago	-2.0	3.8	7.7	8.2	0.7	3.5	3.6	5.1	50.3	1.3	4.3	3.2	-5.1
New Home Prices - Median ($1000's)	82.9	83.7	84.4	85.6	87.1	88.6	90.4	91.8	75.5	80.0	84.2	89.5	95.1
Percent Change - Year Ago	6.4	3.9	4.0	6.6	5.1	5.9	6.9	7.3	8.9	6.0	5.2	6.3	6.3
New Home Prices--Mean ($1000's. Quality Adjusted)	95.2	95.6	96.5	97.2	98.4	99.4	100.8	102.0	89.7	93.7	96.1	100.1	105.5
Percent Change - Year Ago	4.6	2.4	1.5	2.1	3.4	4.0	4.4	4.9	2.1	4.5	2.6	4.2	5.2
NAR Affordability Index	88.4	90.6	93.8	95.9	96.9	97.6	99.2	103.3	82.0	86.2	92.2	99.2	101.0
Mortgage Debt Outstanding ($ billions)	2,077	2,252	2,637	2,956	3,222	3,450	3,652	3,833	1,755	1,956	2,480	3,539	4,216
Homeowners' Equity ($ billions)	2,235	2,244	2,255	2,267	2,292	2,316	2,340	2,366	2,219	2,244	2,250	2,328	2,444
Housing Inventory (millions)	95.3	95.7	96.1	96.6	97.0	97.4	97.8	98.3	92.7	94.4	95.9	97.6	99.3
Rental Vacancy Rate (%)	6.3	6.2	5.9	5.8	5.8	5.9	5.9	5.9	5.6	5.9	6.0	5.9	5.9
Office Vacancy Rate (%)<1>	15.4	16.1	15.3	15.0	14.5	14.3	14.1	14.0	11.7	13.9	15.5	14.2	13.6
Industrial Vacancy Rate (%)<1>	4.0	4.9	4.5	4.5	4.3	4.2	4.0	3.9	4.9	4.7	4.5	4.1	3.5
New Commercial Building Construction (% Ch Value)	52.6	8.4	-5.3	-0.3	-1.6	0.8	2.3	3.9	-4.2	33.7	24.3	0.0	4.7
New Industrial Building Construction (% Ch Value)	21.6	34.5	-11.7	-6.5	-1.6	-2.2	4.5	12.5	-25.7	5.9	15.2	-0.5	14.5
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	10.9	10.6	12.6	7.4	7.0	6.6	5.7	5.2	11.2	6.9	8.4	7.6	5.5
M1 Velocity (% change)	-4.8	-5.3	-6.5	-1.7	-1.3	-1.6	-0.4	1.0	-3.2	3.7	-2.1	-2.1	1.8
M2 (% change)(FED Target 6-9%)	12.6	5.4	10.3	7.8	8.0	7.2	8.0	7.5	12.5	7.9	9.0	7.9	7.0
M2 Velocity (% change)	-6.2	-0.6	-4.5	-2.0	-2.3	-2.1	-2.5	-1.1	-4.4	2.7	-2.7	-2.3	0.4
Monetary Base (% change)	6.8	9.5	8.5	6.3	6.3	5.6	5.4	4.6	9.5	8.1	7.2	6.4	5.0
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	671	662	671	655	685	703	711	729	478	653	665	707	764
Private													
Personal Savings	119	136	110	115	126	129	132	136	118	156	120	131	154
Savings Rate	4.5	5.0	4.0	4.1	4.5	4.5	4.6	4.6	5.0	6.1	4.4	4.5	5.0
Gross Business Savings	544	556	563	564	571	581	585	591	454	519	557	582	614
Government													
Federal	-165	-211	-192	-228	-200	-194	-190	-183	-179	-176	-199	-192	-191
State and Local	54	51	44	56	46	44	45	46	44	53	51	45	58
Foreign (current account deficit)	120	130	145	147	143	142	139	138	41	102	136	141	130
Uses (total:gross investment)	647	641	671	650	673	675	681	691	472	638	652	680	730
Nonresidential Investment													
Equipment	288	296	297	303	304	305	307	313	223	275	296	307	337
Structures	163	168	172	173	173	173	175	177	130	150	169	175	186
Residential Investment	155	158	163	170	176	179	182	186	132	154	162	181	191
Inventory Investment	41	18	39	5	19	18	16	15	-13	58	26	17	16
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	13.7	13.4	12.7	12.4	12.1	11.8	11.5	11.5	13.8	14.5	13.0	11.7	11.9
Real Mortgage Rate (30 yr. avg. is 4.5%)	8.3	10.6	10.0	9.2	8.3	8.4	8.1	7.9	10.1	10.9	9.5	8.2	7.7
1 Year ARM (without buy-down)	11.1	10.2	9.5	9.6	9.3	9.1	9.0	9.1	11.3	12.6	10.1	9.1	9.7
Real Mortgage Rate	5.7	7.4	6.8	6.4	5.5	5.7	5.6	5.5	7.5	9.0	6.6	5.6	5.4
Corporate Bond Rate (AAA)	12.3	11.6	10.9	10.6	10.3	10.1	9.8	9.8	12.0	12.7	11.3	10.0	10.0
Government Bond Rate	11.8	11.1	10.6	10.2	9.6	9.3	9.1	9.2	11.3	12.5	10.9	9.3	9.5
Real Government Bond Rate (30 yr. avg. is 2.1%)	6.4	8.4	7.9	7.0	5.8	5.9	5.7	5.6	7.6	8.9	7.4	5.7	5.2
Federal Funds Rate	8.5	7.9	7.7	7.3	6.7	6.6	6.4	6.7	9.1	10.2	7.9	6.6	7.7
3 Month Treasury Bill Rate	8.2	7.5	7.1	6.8	6.5	6.4	6.3	6.3	8.6	9.5	7.4	6.4	7.1
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	2.8	4.7	4.4	3.6	2.7	3.0	2.8	2.7	4.8	5.9	3.9	2.8	2.8
1 Year Treasury Bill Rate	9.4	8.5	7.8	7.9	7.6	7.4	7.3	7.4	9.6	10.9	8.4	7.4	8.0
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	4.0	5.7	5.1	4.7	3.8	4.0	3.9	3.8	5.8	7.3	4.9	3.9	3.7
Commercial Paper Rate	8.5	7.9	7.5	7.3	6.8	6.7	6.5	6.8	8.9	10.1	7.8	6.7	7.7
Rate on Money Market Fund Shares	8.6	7.9	7.6	7.4	6.9	6.8	6.6	6.9	9.0	10.3	7.9	6.8	7.8
Prime Rate	10.5	10.2	9.4	9.3	8.8	8.8	8.5	8.4	10.8	12.0	9.9	8.6	9.6

<1> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey

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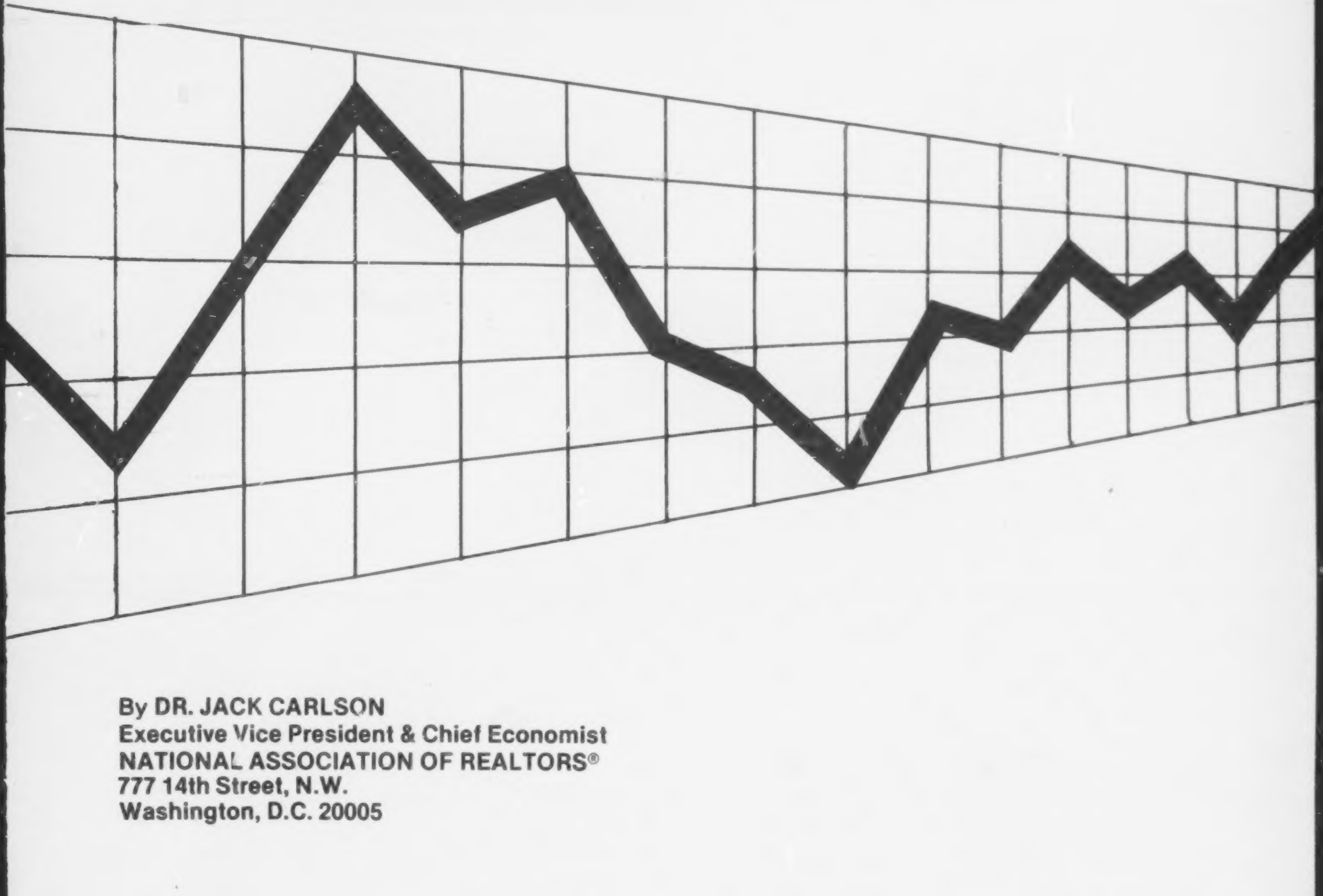
OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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OCTOBER 1985

Outlook For The Economy and Real Estate

After two quarters of below average growth, there is some evidence of a modest rebound. Most of the decline in growth in real economic activity during the first half of 1985 occurred in response to a weakening in consumption and fixed investment and a reduction in inventories. However, if the latest monthly data is an indication of a future trend, economic activity is likely to improve modestly during the last half of the year. According to the August data the interest sensitive industries of housing, auto sales and durable goods have responded strongly to the declines in interest rates. In addition, from June to July, business inventories have been virtually unchanged. These positive forces should push real growth to around 3 percent for the third and fourth quarters.

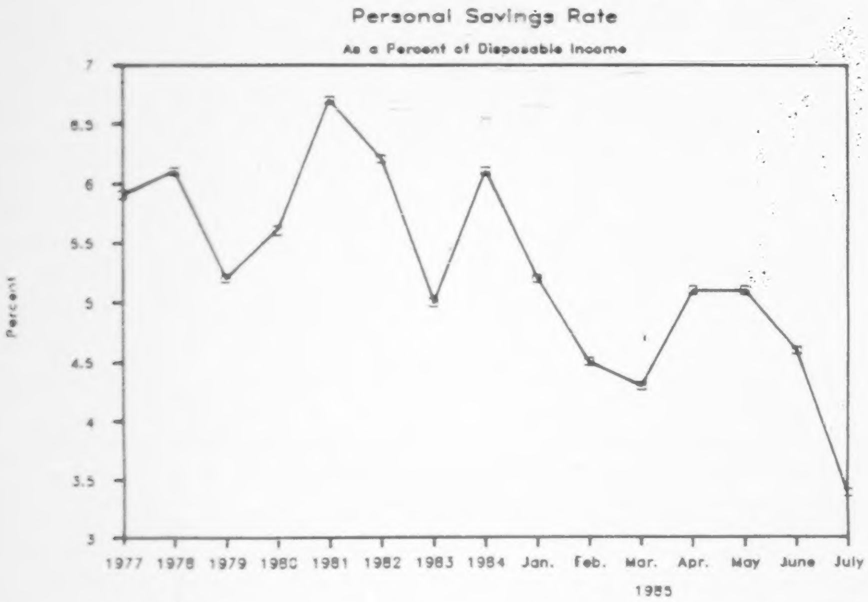
It is interesting to note that the Commerce Department's "flash" GNP estimate of 2.8 percent for the third quarter is not inconsistent with this forecast. In fact since the flash did not include the August increases for housing starts and consumption there is a strong liklihood that this number will be revised upward to around 3 percent.

This rebound may not be sustained. Lower interest rates are encouraging people to go ahead with purchases they otherwise might have delayed until later this year or next. Consequently, the funds needed for the recent spending spree are being borrowed, thus increasing the already massive consumer debt--presently at record levels of 18.6 percent of disposable income. Although the rebound in consumption should push growth in real output to nearly 3 percent for the remainder of the year, by 1986, enormous consumer debt burdens will stifle consumption keeping real output growth below 2 percent for most of 1986.

Because people are consuming more than they are earning, the national savings rate as a percent of disposable income in August declined to an anemic 3.4 percent rate (Figure 1); well below the 8 year average of 6.1 percent. As the pool of savings decline, there are less funds available for investment needed to spur strong and sustainable growth. Demographic trends, as well, are putting downward pressure on savings. Currently, the majority of the population is in the 30 to 45 year old age group--typically the highest debt users with the lowest savings.

The recent decline in the value of the dollar relative to other currency has provided encouraging news to the domestic markets. For the first time since 1979, the trade-weighted value of the dollar is below its year-ago level. This decline has occurred as a result of the recent sluggishness in the U.S. economy and falling U.S. interest rates. Recently, the five major industrial countries--U.S., Japan, West Germany, France, and Britain--have joined forces to further bid down the value of the dollar. This action was taken to circumvent proposed protectionist legislation that is expected in Congress. In response, the value of dollar relative to other currency dropped significantly. The continued depreciation in the value of the dollar through 1985 and 1986 will eventually slow the rate of growth of imports into the U.S. allowing exports to once again regain their share of the market by the end of 1986. However, the intervention by the five industrial countries is likely to have only a modest impact on the dollar in the long-run and more fundamental shifts in the economy are required such as lower interest rates.

Figure 1



Employment and Inflation

The employment figures for August represent a marked improvement over previous months. As nonfarm payroll employment increased 0.3 percent in August, the civilian unemployment rate declined to 7.0 percent. This compares favorably with the 7.3 percent unemployment rate that has prevailed for the last six months. The increase in overall employment in August reflected the recent growth in the interest sensitive industries of housing and automobile sales. In fact, the unemployment rate in the construction industry has declined by over 2 percentage points since last year. In addition, the entire increase in manufacturing employment in August was attributable to auto manufacturing while most other areas of manufacturing employment actually remained unchanged or declined.

The outlook for inflation still remains favorable. The Consumer Price Index advanced only 0.2 percent in August, mainly due to increased costs for housing and home repairs. The Producer Price Index declined in August by 0.2 percent in response to declining energy prices. Prospects for further declines in oil prices should keep prices well in check through 1986 with overall consumer price inflation of 3.1 expected for the entire year.

Despite rapid growth in the money supply, inflation is expected to remain well under control as sluggish growth has kept the capacity utilization rate at 80.5 percent, well below the 83 or 85 percent historically associated with upward pressure on prices. Furthermore, the recent depreciation in the dollar is expected to have very little impact on prices in the near term. By late 1986, however, overall prices could begin to accelerate modestly as the economy begins to pick up steam.

Monetary Policy and Interest Rates

Because the economy continues to experience sluggish growth, the FED has decided to continue to overlook their targets for M1 growth and instead concentrate on enhancing economic growth and stability by avoiding any intentional run ups in the interest rates. Already the FED's "hands-off" policy on money supply growth has averted a near-term recession by allowing interest rates to fall thus providing a much-needed stimulus to the interest sensitive industries. In addition, the recent declines in the value of the dollar relative to other currency diminishes any liklihood of a credit tightening move by the FED. Subsequently, interest rates are expected to decline modestly through the middle of next year before leveling off. At this juncture, the FED has done all it can to help promote stronger growth. It is now up to Congress to reduce the federal deficit, which is keeping real interest rates (inflation-adjusted) at historical highs, dampening overall investment.

Real Estate Markets

The real estate market has exhibited strong growth in August in response to lower overall interest rates. Housing, especially, is responding favorably to the 1.5 percentage point decline in mortgage rates over the past year which has given many families the affordability break they have been anticipating. Underscoring the improvement in affordability was an increase in the NAR Affordability index to 94.8 percent in August, the highest level since 1979.

Lower interest rates combined with the strong demand for homeownership boosted the seasonally adjusted annual rate of existing single family home sales to 3.43 million units in August--the highest level in nearly six years. August's 9.2 percent increase in the annual home resale rate from the upwardly revised July rate of 3.14 million units was the largest month-to-month increase since January 1983 when a 13.5 percent increase occurred. In addition, the home resale pace in August was up 23.8 percent from the August 1984 pace of 2.77 million units. For all of 1985 3.13 million existing homes are expected to be sold each year. As mortgage interest rates continue to trend downward through 1986, existing home sales should increase to 3.19 million units.

Builders, as well, are becoming more confident about interest rates and the fate of investment incentives as seen in a 6.2 percent increase in total housing starts in August. Most of the increase was attributable to a 15 6 percent increase in multi-family starts reversing the July decline of 12.7 percent. The outlook for housing starts remains favorable as evidenced by a 12.0 percent increase in building permits for single family homes. For all of 1985, 1.82 million houses are expected to be started. By 1986, 1.9 million starts are expected.

The outlook for nonresidential investment remains mixed. As the manufacturing sector remains depressed due to the increased domination of imports, industrial building construction is expected to decline through 1985 and 1986. Office building construction, although advancing during the first half of the year due to grandfathering of depreciation rates of tax "reform" proposals, is expected to respond negatively to the recent run ups in the office vacancy rates. The one bright spot in nonresidential construction will be in stores, shopping centers and warehouses. These areas have benefitted greatly from the recent gains in housing and are expected to experience strong growth through the remainder of 1985 and into 1986 as lower interest rates continue to stimulate housing demand.

OCTOBER 1985

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product ($ billions)	3,811	3,853	3,910	3,967	4,013	4,058	4,102	4,162	3,305	3,663	3,885	4,084	4,387
Percent Change	5.6	4.5	6.1	5.9	4.8	4.5	4.5	6.0	7.7	10.8	6.1	5.1	7.4
Percent Change (without inflation)	0.3	1.9	3.0	2.2	1.7	1.6	1.5	2.5	3.7	6.8	2.3	2.0	3.5
Consumption	5.2	4.8	4.7	-1.3	1.9	2.0	1.5	1.5	4.8	5.3	3.9	1.8	2.6
Durables	9.2	6.8	16.8	-17.7	1.4	3.1	0.2	0.8	12.1	13.1	7.1	-0.4	3.1
Nondurables	3.7	4.7	0.5	1.6	1.8	1.0	1.1	0.9	3.7	4.6	2.3	1.5	1.8
Services	5.0	4.2	3.6	3.4	2.2	2.3	2.3	2.3	3.4	3.2	4.1	2.8	2.9
Residential Investment	5.5	6.1	3.5	11.0	12.1	5.5	3.4	4.3	41.7	12.2	1.9	7.6	0.0
Nonresidential Investment	-1.5	14.4	2.1	-1.8	-2.2	-2.5	-1.7	1.9	2.5	19.8	6.8	-0.4	4.6
Structures	9.5	9.2	-1.1	-1.3	-3.4	-6.0	-5.9	-2.3	-7.8	15.6	8.4	-2.7	0.9
Equipment	-5.6	16.6	3.5	-2.0	-1.7	-1.1	-0.1	3.6	7.3	21.5	6.2	0.6	5.9
Exports	-8.9	-15.2	0.0	10.6	9.3	10.2	10.7	10.8	-5.6	4.7	-4.0	7.1	9.7
Imports	32.2	-0.7	-0.6	9.7	-2.4	-2.7	-2.9	-3.1	7.6	27.0	7.3	-0.1	0.4
Government Purchases	0.3	3.7	4.8	6.4	-2.2	-2.3	-0.6	0.9	-0.3	3.5	4.6	0.9	2.9
Consumption (% of GNP)	65.5	65.9	66.2	65.6	65.7	65.7	65.7	65.6	65.8	64.8	65.8	65.7	65.1
Residential Investment (% of GNP)	3.6	3.6	3.6	3.7	3.8	3.9	3.9	3.9	3.5	3.7	3.7	3.9	3.7
Nonresidential Investment (% of GNP)	12.8	13.2	13.2	13.0	12.9	12.8	12.7	12.6	11.1	12.5	13.0	12.7	12.9
Structures (% of GNP)	3.7	3.7	3.7	3.6	3.6	3.5	3.5	3.4	3.2	3.5	3.7	3.5	3.4
Equipment (% of GNP)	9.1	9.5	9.5	9.4	9.3	9.2	9.2	9.2	7.9	9.0	9.4	9.2	9.5
Inventory Change ($ billions)	40.7	17.9	6.3	24.6	21.3	18.9	14.1	10.5	-13.5	58.2	22.4	16.2	9.9
Mfg. Capacity Utilization Rate (%)	81	80	80	80	79	78	78	78	74	81	80	78	80
Auto Sales (millions of units)	10.8	10.9	12.0	10.5	10.5	10.6	10.5	10.5	9.2	10.4	11.1	10.5	10.7
Domestic (% of total)	78.0	75.5	75.3	69.8	72.7	69.6	68.4	67.0	74.0	76.5	74.7	69.4	65.9
Imported (% of total)	22.0	24.5	24.7	30.2	27.3	30.4	31.6	33.0	26.0	23.5	25.3	30.6	34.1
Manufacturing Industrial Production (% change)	0.7	2.0	2.0	2.0	0.1	-0.6	2.8	4.0	7.8	11.3	2.5	1.3	6.1
Common Market	2.5	0.0	3.1	1.6	2.0	2.3	1.3	2.5	1.0	3.2	2.0	1.9	1.6
Japan	-2.6	12.5	-0.2	2.4	9.1	4.6	3.8	3.4	3.5	11.0	5.2	5.0	2.0
Trade Deficit	121	127	124	134	128	127	123	116	41	102	127	123	103
Value of the U.S. Dollar (Weighted by Trade)	1.350	1.313	1.235	1.179	1.129	1.084	1.046	1.026	1.142	1.224	1.269	1.071	1.022
Percent Change - Year Ago	15.2	10.5	-1.3	-8.1	-16.3	-17.4	-15.3	-12.9	4.0	7.2	3.7	-15.6	-4.6
Employment(millions)(civilian:household basis)	106.7	106.8	107.1	107.6	107.9	108.2	108.5	108.9	100.8	105.0	107.0	108.4	110.4
Percent Change	3.0	0.1	1.4	1.7	1.1	1.4	1.1	1.4	1.3	4.1	1.9	1.2	1.8
Unemployment Rate (%) (civilian)	7.3	7.3	7.2	7.3	7.3	7.4	7.6	7.7	9.6	7.5	7.3	7.5	7.6
Personal Income per Household (average)<1>	40,078	40,384	40,645	41,248	41,756	42,227	42,677	43,176	35,410	38,527	40,589	42,459	45,043
Percent Change -- Year Ago (w/o inflation)	3.5	2.1	1.3	1.1	0.9	1.1	1.4	1.1	1.5	5.4	2.0	1.1	2.2
Personal Taxes per Household (average)	7,740	7,250	7,682	7,815	7,939	8,053	8,164	8,291	6,478	6,956	7,622	8,112	8,685
Percent Change -- Year Ago (w/o inflation)	10.6	1.4	5.7	5.2	-0.5	7.7	3.1	2.9	-3.0	3.5	5.7	3.2	3.1
Percent of Personal Income	20.2	18.8	19.8	19.8	19.9	20.0	20.0	20.1	19.1	18.8	19.7	20.0	20.2
Disposable Income per Household (average)	32,338	33,134	32,963	33,432	33,816	34,174	34,513	34,885	28,938	31,571	32,967	34,347	36,358
Percent Change--Year Ago (w/o inflation)	2.0	2.5	0.6	0.5	1.5	-0.1	1.2	0.8	2.5	5.7	1.4	0.8	2.0
Household Debt (% of total)	23.1	23.6	24.4	24.5	24.5	24.6	24.6	24.5	19.7	21.2	23.9	24.5	23.8
Household Interest Payments (% of total)	10.4	10.5	11.1	11.1	11.0	11.0	10.9	10.3	9.7	10.4	10.8	10.8	10.1
Consumer Price Inflation (CPI)	3.3	4.2	2.2	2.8	3.1	3.3	3.4	3.5	3.2	4.3	3.4	3.1	3.8
Gross National Product Inflation (GNP Deflator)	5.4	2.6	3.0	3.6	3.0	2.9	2.9	3.4	3.8	3.8	3.6	3.1	3.8
Personal Consumption Inflation	3.3	2.9	2.5	3.7	3.3	3.5	3.3	3.7	3.7	3.2	3.0	3.3	3.8
Residential Construction Inflation	-0.6	1.2	2.9	3.1	3.9	4.1	4.1	4.4	1.7	3.9	2.0	3.6	4.7
Nonresidential Construction Inflation	3.4	4.4	3.5	3.7	3.8	4.0	4.0	4.0	-1.0	0.3	2.9	3.8	4.1
Producers Price Inflation (WPI)	-1.8	-0.3	-1.0	1.7	1.2	2.1	1.4	2.4	1.3	2.4	-0.5	1.2	2.7
Compensation per Manhour (% change)	5.0	3.3	1.9	4.1	4.6	4.0	4.2	4.4	4.8	4.2	3.7	3.9	5.2
Productivity (% change)	-3.3	1.1	1.2	0.8	0.7	0.8	0.8	1.6	3.4	2.7	0.2	0.9	1.7
Unit Labor Cost (% change)	8.5	2.2	0.6	3.2	3.9	3.2	3.3	2.8	1.3	1.4	3.5	3.0	3.4
Before Tax Corporate Profits ($ billions)<2>	229	227	218	223	225	227	228	236	213	243	224	229	269
Corporate Tax Liability	92	89	82	84	86	86	86	90	86	98	87	87	108
After Tax Profits	137	137	136	139	139	141	142	146	127	146	137	142	161
Inventory Valuation Adjustment	1	3	2	-7	-10	-12	-12	-14	-11	-6	0	-12	-18
Capital Consumption Adjustment	69	75	79	85	86	84	80	79	33	56	77	82	72
Profits from Current Production (with IVA, CCA)	207	215	217	217	214	213	211	211	149	196	214	212	214
Adjusted for Inflation (85:1 base)	207	214	214	212	208	205	202	200	159	201	212	204	198
Percent Change - Year Ago	7.9	6.2	5.1	2.6	0.4	-3.9	-5.8	-5.7	46.0	26.5	5.4	-3.8	-2.7
Per Unit of Output (% of GNP)	5.4	5.6	5.6	5.5	5.3	5.2	5.1	5.1	4.5	5.3	5.5	5.2	4.9
Effective Corporate Tax Rate (%)<2>	30	28	26	27	28	28	28	29	34	32	28	28	33
Federal Tax Receipts (Unified basis)	696	826	745	685	674	919	759	722	613	683	738	769	839
Percent of GNP	18.3	21.4	19.1	17.3	16.8	22.7	18.5	17.3	18.6	18.7	19.0	18.8	19.1
Federal Expenditures (Unified basis)	919	936	924	990	977	971	946	1,010	803	868	942	976	1,055
Percent of GNP	24.1	24.3	23.6	24.9	24.4	23.9	23.1	24.3	24.3	23.7	24.2	23.9	24.1
Surplus or Deficit (Unified basis)	-223	-110	-179	-305	-303	-52	-188	-288	-190	-184	-204	-208	-216
% of GNP	5.8	2.8	4.6	7.7	7.6	1.3	4.6	6.9	5.8	5.0	5.2	5.1	4.9
% of Personal Savings	187.8	78.7	212.9	270.1	258.8	44.1	157.0	235.5	138.1	117.2	187.4	173.8	152.1
% of Net Domestic Savings	75.5	34.4	68.1	106.3	106.2	18.3	66.6	101.7	80.0	56.5	71.1	73.2	68.6

<1> Includes personal contributions for social insurance.
<2> Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach, and Janemarie Mulvey.

Table 2

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	85:1	85:2	85:3	85:4	86:1	86:2	86:3	86:4	1983	1984	1985	1986	1987
REAL ESTATE MARKETS													
Total Single-Family Home Sales (thousands) (single-family resales and completions)	4,057	4,089	4,390	4,366	4,360	4,375	4,383	4,415	3,750	3,936	4,226	4,383	4,090
Percent Change -- Year Ago	-1.9	0.8	17.9	14.1	7.5	7.0	-0.2	1.1	42.4	5.0	7.4	3.7	-6.7
Existing Single-Family Home Sales (thousands)	2,970	3,047	3,300	3,200	3,174	3,193	3,193	3,202	2,716	2,866	3,129	3,190	2,984
Percent Change - Year Ago	1.9	2.5	19.4	13.8	6.9	4.8	-3.3	0.0	36.5	5.5	9.2	1.9	-6.5
Dollar Volume (billions)	260.8	275.4	301.5	281.4	283.6	289.1	294.7	285.3	224.2	246.6	279.8	288.2	276.8
Existing Home Prices - Median ($1000's)	73.8	75.2	76.9	74.6	76.4	77.9	79.8	77.3	69.8	72.3	75.1	77.9	81.0
Percent Change - Year Ago	3.6	3.4	5.1	3.7	3.5	3.6	3.8	3.6	3.2	3.5	3.9	3.6	4.0
Monthly Mortgage Payment (P&I, 80%, 30 yr.)	657	654	633	610	620	622	622	584	628	680	638	612	650
Percent of Median Family Income	30	29	28	27	27	27	27	25	32	32	29	26	26
Private Housing Starts (thousands)	1,795	1,772	1,801	1,913	1,877	1,881	1,903	1,940	1,703	1,766	1,820	1,900	1,790
Percent Change - Year Ago	-7.8	-4.6	8.3	19.7	4.5	6.2	5.6	1.4	61.0	3.8	3.0	4.4	-5.8
Single-Family	1,121	1,075	1,123	1,202	1,223	1,218	1,228	1,251	1,066	1,103	1,130	1,230	1,140
Percent of Total	62.5	60.7	62.4	62.8	65.2	64.8	64.5	64.5	62.6	62.4	62.1	64.7	63.7
Multi-Family	674	697	678	711	654	663	675	689	637	664	690	670	650
Percent of Total	37.5	39.3	37.6	37.2	34.8	35.2	35.5	35.5	37.4	37.6	37.9	35.3	36.3
Mobile Home Shipments	277	281	293	293	285	285	285	286	296	295	286	285	278
New Single-Family Home Sales (thousands)	669	674	718	705	678	681	685	695	629	637	692	685	642
Percent Change - Year Ago	-2.0	6.5	16.9	14.2	1.3	1.0	-4.5	-1.4	50.3	1.3	8.6	-1.0	-6.2
New Home Prices - Median ($1000's)	82.9	83.7	84.7	85.5	86.6	87.9	89.4	91.1	75.5	80.0	84.2	88.8	93.7
Percent Change - Year Ago	6.4	4.0	4.2	6.4	4.5	5.0	5.5	6.5	8.9	6.0	5.2	5.4	5.6
New Home Prices--Mean ($1000's, Quality Adjusted)	95.2	95.6	96.1	96.8	97.8	98.9	99.8	100.8	89.7	93.7	95.9	99.3	104.0
Percent Change - Year Ago	4.6	2.4	1.1	1.6	2.8	3.5	3.8	4.1	2.1	4.5	2.4	3.6	4.7
NAR Affordability Index	88.4	90.6	92.7	95.2	95.2	95.5	94.9	101.4	82.0	86.2	91.7	96.7	98.3
Mortgage Debt Outstanding ($ billions)	2,071	2,136	2,258	2,345	2,395	2,468	2,525	2,595	1,755	,952	2,202	2,496	2,755
Homeowners' Equity ($ billions)	2,239	2,236	2,254	2,274	2,298	2,324	2,350	2,379	2,219	2,238	2,251	2,338	2,477
Housing Inventory (millions)	95.3	95.7	96.1	96.5	97.0	97.4	97.8	98.2	92.7	94.4	95.9	97.6	99.3
Rental Vacancy Rate (%)	6.3	6.2	6.0	5.9	5.8	5.7	5.8	5.8	5.6	5.9	6.1	5.8	5.9
Office Vacancy Rate (%)<1>	15.4	16.1	15.3	15.0	14.5	14.3	14.1	14.0	11.7	13.9	15.5	14.2	13.6
Industrial Vacancy Rate (%)<1>	4.0	4.9	4.5	4.5	4.3	4.2	4.0	3.9	4.9	4.7	4.5	4.1	3.5
New Commercial Building Construction (% Ch Value)	52.6	5.8	3.8	-4.9	-6.9	-0.5	-9.8	1.5	-4.2	33.7	24.8	-3.2	3.4
New Industrial Building Construction (% Ch Value)	21.6	32.3	-4.1	-5.9	-1.4	-1.9	4.8	12.0	-25.7	5.9	16.0	0.6	14.2
FINANCIAL MARKETS													
Money Supply													
M1 (% change)(FED Target 4-7%)	10.9	10.6	16.3	8.0	6.7	6.4	5.8	5.2	11.2	6.9	8.8	8.0	5.4
M1 Velocity (% change)	-4.8	-5.5	-8.8	-1.9	-1.9	-1.8	-1.3	0.7	-3.2	3.7	-2.5	-2.8	1.9
M2 (% change)(FED Target 6-9%)	12.6	5.4	10.4	7.2	6.3	6.5	7.9	7.4	12.5	7.9	9.0	7.2	7.1
M2 Velocity (% change)	-6.2	-0.8	-3.9	-1.2	-1.5	-1.9	-3.2	-1.3	-4.4	2.7	-2.6	-2.0	0.3
Monetary Base (% change)	6.6	9.6	9.5	4.8	7.8	5.9	6.5	5.3	9.5	8.1	7.2	6.9	5.5
Flow of Funds (NIA Basis)													
Sources (total:gross savings)	672	660	627	658	668	684	690	697	478	653	654	685	724
Private													
Personal Savings	119	139	84	113	117	117	120	122	118	156	114	119	142
Savings Rate	4.5	5.1	3.1	4.1	4.2	4.1	4.2	4.2	5.0	6.1	4.2	4.2	4.6
Gross Business Savings	544	557	565	570	572	578	583	588	454	519	559	580	609
Government													
Federal	-165	-214	-195	-204	-194	-184	-181	-176	-179	-176	-194	-184	-189
State and Local	54	50	48	45	44	45	46	46	44	53	49	45	59
Foreign (current account deficit)	121	127	124	134	128	127	123	116	41	102	127	123	103
Uses (total:gross investment)	647	643	639	664	668	670	671	677	472	638	648	672	712
Nonresidential Investment													
Equipment	288	299	303	303	304	306	309	314	223	275	298	308	339
Structures	163	168	169	170	170	169	169	169	130	150	168	169	178
Residential Investment	155	158	160	166	172	176	180	183	132	154	160	178	186
Inventory Investment	41	18	6	25	21	19	14	10	-13	58	22	16	10
Selected Interest Rates (Percent)													
Mortgage Commitment Rates													
30 Year,Fixed-Rate	13.7	13.4	12.6	12.5	12.4	12.2	11.9	11.5	13.8	14.5	13.0	12.0	12.3
Real Mortgage Rate (30 yr. avg. is 4.5%)	8.3	10.8	9.6	8.9	9.4	9.3	9.0	8.1	10.1	10.9	9.4	8.9	7.9
1 Year ARM (without buy-down)	11.1	10.2	9.7	9.8	9.6	9.3	9.3	9.3	11.3	12.6	10.2	9.4	10.0
Real Mortgage Rate	5.7	7.6	6.7	6.1	6.6	6.5	6.4	5.9	7.5	9.0	6.5	6.3	5.6
Corporate Bond Rate (AAA)	12.3	11.6	10.9	10.7	10.7	10.5	10.3	9.9	12.0	12.7	11.4	10.3	10.6
Government Bond Rate	11.8	11.1	10.6	10.3	10.0	9.6	9.4	9.1	11.3	12.5	11.0	9.5	10.0
Real Government Bond Rate (30 yr. avg. is 2.1%)	6.4	8.5	7.6	6.7	7.0	6.7	6.5	5.7	7.6	8.9	7.3	6.5	5.6
Federal Funds Rate	8.5	7.9	7.8	7.7	7.3	7.0	6.7	6.8	9.1	10.2	8.0	7.0	7.7
3 Month Treasury Bill Rate	8.2	7.5	7.1	7.0	6.8	6.5	6.5	6.5	8.6	9.5	7.4	6.6	7.3
Real 3 Month T-Bill Rate (30 yr. avg is 1.2%)	2.8	4.9	4.1	3.4	3.8	3.7	3.6	3.1	4.8	5.9	3.8	3.5	2.9
1 Year Treasury Bill Rate	9.4	8.5	8.0	8.1	7.9	7.6	7.6	7.6	9.6	10.9	8.5	7.7	8.3
Real 1 Year T-Bill Rate (30 yr. avg is 1.7%)	4.0	5.9	5.0	4.4	4.9	4.8	4.7	4.2	5.8	7.3	4.8	4.6	3.9
Commercial Paper Rate	8.5	7.9	7.7	7.7	7.3	7.0	6.8	6.9	8.9	10.1	7.9	7.0	7.8
Rate on Money Market Fund Shares	8.6	7.9	7.7	7.8	7.4	7.1	6.9	7.0	9.0	10.3	8.0	7.1	7.9
Prime Rate	10.5	10.2	9.5	9.4	9.3	9.0	8.8	8.6	10.8	12.0	9.9	8.9	9.7

<1> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Dr. Richard Peach and Janemarie Mulvey